

Teekay Offshore Partners L.P.
Form 6-K
May 19, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 6-K

Report of Foreign Private Issuer
Pursuant to Rule 13a-16 or 15d-16
of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2014

Commission file number 1-33198

TEEKAY OFFSHORE PARTNERS L.P.
(Exact name of Registrant as specified in its charter)

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4th Floor, Belvedere Building, 69 Pitts Bay Road, Hamilton, HM 08, Bermuda

(Address of principal executive office)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F Form 40-F

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1).

Yes No

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7).

Yes No

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TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES

REPORT ON FORM 6-K FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2014

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ITEM 1 FINANCIAL STATEMENTS

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

(in thousands of U.S. dollars, except unit and per unit data)

	Three Months Ended March 31,	
	2014	2013
	\$	\$
REVENUES (note 7)	259,234	212,112
OPERATING EXPENSES		
Voyage expenses	33,454	22,948
Vessel operating expenses (note 7, 8)	88,130	77,324
Time-charter hire expense	11,412	14,777
Depreciation and amortization	48,488	44,510
General and administrative (note 7, 8)	14,849	10,390
Restructuring charge (note 6)	559	659
Total operating expenses	196,892	170,608
Income from vessel operations	62,342	41,504
OTHER ITEMS		
Interest expense (note 5, 7)	(18,920)	(11,628)
Interest income	177	195
Realized and unrealized losses on derivative instruments (note 8)	(36,632)	(1,077)
Equity income	3,703	
Foreign currency exchange loss (note 8)	(775)	(3,638)
Loss on bond repurchase (note 5)		(1,759)
Other income net	390	314
Total other items	(52,057)	(17,593)
Income from continuing operations before income tax (expense) recovery	10,285	23,911
Income tax (expense) recovery (note 9)	(1,263)	234
Net income from continuing operations	9,022	24,145
Net loss from discontinued operations (note 13)		(2,175)
Net income	9,022	21,970
Non-controlling interests in net income	1,679	1,777

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Preferred unitholders interest in net income (<i>note 11</i>)	2,719	
General Partner s interest in net income from continuing operations	3,943	3,405
General Partner s interest in net loss from discontinued operations		(332)
General Partner s interest in net income	3,943	3,073
Limited partners interest in net income from continuing operations	681	18,963
Limited partners interest in net income from continuing operations per common unit basic (<i>note 11</i>)	0.01	0.24
Limited partners interest in net income from continuing operations per common unit diluted (<i>note 11</i>)	0.01	0.24
Limited partners interest in net loss from discontinued operations		(1,843)
Limited partners interest in net loss from discontinued operations per common unit basic (<i>note 11</i>)		(0.02)
Limited partners interest in net loss from discontinued operations per common unit diluted (<i>note 11</i>)		(0.02)
Limited partners interest in net income	681	17,120
Limited partners interest in net income per common unit basic (<i>note 11</i>)	0.01	0.21
Limited partners interest in net income per common unit diluted (<i>note 11</i>)	0.01	0.21
Weighted-average number of common units basic	85,455,292	80,105,408
Weighted-average number of common units diluted	85,480,352	80,106,741
Cash distributions declared per unit	0.5384	0.5253

Related party transactions (*note 7*)

The accompanying notes are an integral part of the unaudited consolidated financial statements.

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TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands of U.S. dollars)

	Three Months Ended	
	March 31,	
	2014	2013
	\$	
Net income	9,022	21,970
Other comprehensive income:		
Unrealized net gain on qualifying cash flow hedging instruments <i>(note 8)</i>		6
Realized net loss on qualifying cash flow hedging instruments <i>(note 8)</i>		52
Other comprehensive income		58
Comprehensive income	9,022	22,028
Non-controlling interests in comprehensive income	1,679	1,777
Preferred unitholders' interest in comprehensive income	2,719	
General and limited partners' interest in comprehensive income	4,624	20,251

The accompanying notes are an integral part of the unaudited consolidated financial statements.

Table of Contents**TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES****UNAUDITED CONSOLIDATED BALANCE SHEETS**

(in thousands of U.S. dollars)

	As at March 31, 2014 \$	As at December 31, 2013 \$
ASSETS		
Current		
Cash and cash equivalents	222,990	219,126
Accounts receivable, including non-trade of \$40,712 (December 31, 2013 \$40,043) (notes 8 and 10a)	169,021	176,265
Net investments in direct financing leases current (note 3b)	4,830	5,104
Prepaid expenses	36,525	31,675
Due from affiliates (note 7b)	19,675	15,202
Current portion of derivative instruments (note 8)	1,546	500
Other current assets	3,384	3,051
Total current assets	457,971	450,923
Vessels and equipment		
At cost, less accumulated depreciation of \$1,064,283 (December 31, 2013 \$1,016,812)	3,067,880	3,089,582
Advances on newbuilding contracts (note 14)	46,369	
Investment in equity accounted joint venture	55,824	52,120
Net investments in direct financing leases (note 3b)	21,305	22,463
Derivative instruments (note 8)	12,168	10,323
Deferred tax asset	7,981	7,854
Other assets	37,307	35,272
Intangible assets net	9,429	10,436
Goodwill	129,145	127,113
Total assets	3,845,379	3,806,086
LIABILITIES AND EQUITY		
Current		
Accounts payable	18,518	15,753
Accrued liabilities (notes 6, 8 and 10a)	134,756	138,156
Deferred revenues	24,437	29,075
Due to affiliates (note 7b)	80,183	121,864
Current portion of long-term debt (note 5)	748,055	806,009
Current portion of derivative instruments (note 8)	55,165	47,944
Current portion of in-process revenue contracts	12,744	12,744

Total current liabilities	1,073,858	1,171,545
Long-term debt (<i>note 5</i>)	1,730,873	1,562,967
Derivative instruments (<i>note 8</i>)	131,302	121,135
In-process revenue contracts	85,407	88,550
Other long-term liabilities	23,480	23,984
Total liabilities	3,044,920	2,968,181
Commitments and contingencies (<i>notes 5, 8, and 10</i>)		
Redeemable non-controlling interest (<i>note 10b</i>)	15,911	16,564
Equity		
Limited partners common units (85.5 million and 85.5 million units issued and outstanding at March 31, 2014 and December 31, 2013, respectively)	579,830	621,002
Limited partners preferred units (6.0 million and 6.0 million units issued and outstanding at March 31, 2014 and December 31, 2013, respectively) (<i>note 11</i>)	144,800	144,800
General Partner	20,399	21,242
Partners equity	745,029	787,044
Non-controlling interests	39,519	34,297
Total equity	784,548	821,341
Total liabilities and equity	3,845,379	3,806,086

The accompanying notes are an integral part of the unaudited consolidated financial statements.

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TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands of U.S. dollars)

	Three Months Ended March 31,	
	2014	2013
	\$	\$
Cash and cash equivalents provided by (used for)		
OPERATING ACTIVITIES		
Net income	9,022	21,970
Non-cash items:		
Unrealized loss on derivative instruments (<i>note 8</i>)	14,497	12,368
Equity income	(3,703)	
Depreciation and amortization	48,488	45,349
Write-down of vessel (<i>note 13</i>)		11,247
Deferred income tax expense (recovery) (<i>note 9</i>)	10	(108)
Amortization of in-process revenue contracts	(3,142)	(3,142)
Foreign currency exchange loss (gain) and other	8,629	(23,004)
Change in non-cash working capital items related to operating activities	(49,017)	(17,361)
Expenditures for dry docking	(5,212)	(972)
Net operating cash flow	19,572	46,347
FINANCING ACTIVITIES		
Proceeds from long-term debt	208,821	234,986
Scheduled repayments of long-term debt	(37,999)	(23,019)
Prepayments of long-term debt	(70,000)	(90,352)
Debt issuance costs	(2,250)	(5,091)
Indemnification on <i>Voyageur Spirit</i> FPSO from Teekay Corporation (<i>note 7c</i>)	3,474	
Realized gain on cross currency swap (<i>note 8</i>)		6,800
Cash distributions paid by the Partnership	(57,204)	(44,209)
Other	7,111	(158)
Net financing cash flow	51,953	78,957
INVESTING ACTIVITIES		
Expenditures for vessels and equipment	(66,772)	(23,785)
Proceeds from sale of vessels and equipment		13,250
Prepayment of purchase of <i>Voyageur Spirit</i> FPSO (<i>note 7c</i>)		(150,000)
Direct financing lease payments received	1,433	1,693
Acquisition of ALP Maritime Services B.V. (net of cash acquired of \$0.3 million) (<i>note 14</i>)	(2,322)	
Net investing cash flow	(67,661)	(158,842)

Increase (decrease) in cash and cash equivalents	3,864	(33,538)
Cash and cash equivalents, beginning of the period	219,126	206,339
Cash and cash equivalents, end of the period	222,990	172,801

The accompanying notes are an integral part of the unaudited consolidated financial statements.

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TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENT OF CHANGES IN TOTAL EQUITY

(in thousands of U.S. dollars and units)

	PARTNERS EQUITY							Total Equity \$	Redeemable Non- controlling Interest \$
	Limited Partners Common Units and Common Units #	Paid-in Capital \$	Preferred Units #	Preferred Units \$	General Partner \$	Non- controlling Interests \$			
Balance as at December 31, 2013	85,453	621,002	6,000	144,800	21,242	34,297	821,341	16,564	
Net income		681		2,719	3,943	1,679	9,022		
Reclassification of redeemable non-controlling interest in net income						(847)	(847)	847	
Cash distributions		(46,008)		(2,719)	(4,867)		(53,594)		
Distribution of capital to joint venture partner						(2,110)	(2,110)	(1,500)	
Contribution of capital from joint venture partner						6,500	6,500		
Indemnification of Voyageur LLC from Teekay Corporation (note 7c)		3,405			69		3,474		
Equity based compensation and other (notes 7a and 12)	15	750			12		762		
Balance as at March 31, 2014	85,468	579,830	6,000	144,800	20,399	39,519	784,548	15,911	

The accompanying notes are an integral part of the unaudited consolidated financial statements.

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TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data)

1. Basis of Presentation

The unaudited interim consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles (or *GAAP*). These financial statements include the accounts of Teekay Offshore Partners L.P., which is a limited partnership organized under the laws of the Republic of The Marshall Islands and its wholly owned or controlled subsidiaries (collectively, the *Partnership*). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Certain information and footnote disclosures required by GAAP for complete annual financial statements have been omitted and therefore, these interim financial statements should be read in conjunction with the Partnership's audited consolidated financial statements for the year ended December 31, 2013, which are included in the Partnership's Annual Report on Form 20-F. In the opinion of management of our general partner, Teekay Offshore GP L.L.C. (or the *General Partner*), these interim unaudited consolidated financial statements reflect all adjustments, which are of a normal recurring nature, necessary to present fairly, in all material respects, the Partnership's consolidated financial position, results of operations, changes in total equity and cash flows for the interim periods presented. The results of operations for the interim periods presented are not necessarily indicative of those for a full fiscal year. Historically, the utilization of shuttle tankers in the North Sea is higher in the winter months and lower in the summer months, as generally there is higher maintenance in the oil fields during the summer months, which leads to lower oil production, and thus, lower shuttle tanker utilization during that period. Significant intercompany balances and transactions have been eliminated upon consolidation.

2. Accounting Pronouncement Not Yet Adopted

In April 2014, the Financial Accounting Standards Board (or *FASB*) issued Accounting Standards Update 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity* (or *ASU 2014-08*) which raises the threshold for disposals to qualify as discontinued operations. A discontinued operation is defined as: (1) a component of an entity or group of components that has been disposed of or classified as held for sale and represents a strategic shift that has or will have a major effect on an entity's operations and financial results; or (2) an acquired business that is classified as held for sale on the acquisition date. ASU 2014-08 also requires additional disclosures regarding discontinued operations, as well as material disposals that do not meet the definition of discontinued operations. ASU 2014-08 is effective for fiscal years beginning on or after December 15, 2014, and interim periods within those years. Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been reported in the financial statements previously issued or available for issuance. The impact, if any, of adopting ASU 2014-08 on the Partnership's financial statements will depend on the occurrence and nature of disposals that occur after ASU 2014-08 is adopted.

3. Financial Instruments

a) Fair Value Measurements

For a description of how the Partnership estimates fair value and for a description of the fair value hierarchy levels, see Note 3 in the Partnership's audited consolidated financial statements filed with its Annual Report on Form 20-F for the year ended December 31, 2013. The following table includes the estimated fair value and carrying value of those assets and liabilities that are measured at fair value on a recurring and non-recurring basis, as well as the estimated fair value of the Partnership's financial instruments that are not accounted for at fair value on a recurring basis.

	Fair Value Hierarchy Level	March 31, 2014		December 31, 2013	
		Carrying Amount Asset (Liability) \$	Fair Value Asset (Liability) \$	Carrying Amount Asset (Liability) \$	Fair Value Asset (Liability) \$
Recurring:					
Cash and cash equivalents	Level 1	222,990	222,990	219,126	219,126
Derivative instruments (note 8)					
Interest rate swap agreements	Level 2	(164,011)	(164,011)	(141,143)	(141,143)
Cross currency swap agreements	Level 2	(17,878)	(17,878)	(25,433)	(25,433)
Foreign currency forward contracts	Level 2	1,194	1,194	(842)	(842)
Non-Recurring:					
Vessels and equipment	Level 2			17,250	17,250
Other:					
Long-term debt public (note 5)	Level 1	(658,427)	(668,799)	(487,097)	(496,609)
Long-term debt non-public (note 5)	Level 2	(1,820,501)	(1,789,482)	(1,881,879)	(1,835,218)

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(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data)

b) Financing Receivables

The following table contains a summary of the Partnership's financing receivables by type of borrower and the method by which the Partnership monitors the credit quality of its financing receivables on a quarterly basis:

	Credit Quality Indicator	Grade	March 31, 2014 \$	December 31, 2013 \$
Direct financing leases	Payment activity	Performing	26,135	27,567

4. Segment Reporting

The following table includes results for the Partnership's shuttle tanker segment, floating production, storage and off-loading (or *FPSO*) unit segment, floating, storage and off-take (or *FSO*) unit segment, conventional tanker segment, and towage segment for the periods presented in these consolidated financial statements. The results below exclude three conventional tankers as they are determined to be discontinued operations (see note 13):

	Shuttle Tanker Segment		FPSO Segment ⁽¹⁾		FSO Segment		Conventional Tanker Segment		Total	
	2014 \$	2013 \$	2014 \$	2013 \$	2014 \$	2013 \$	2014 \$	2013 \$	2014 \$	2013 \$
Revenues	153,180	130,350	83,137	57,685	14,289	15,140	8,628	8,937	259,234	212,112
Voyage expenses (recoveries)	31,706	22,294			23	(485)	1,725	1,139	33,454	22,948
Vessel operating expenses	40,406	37,967	40,391	29,501	5,873	8,285	1,460	1,571	88,130	77,324
Time-charter hire expense	11,412	14,777							11,412	14,777
Depreciation and amortization	27,281	27,605	17,903	12,752	1,693	2,582	1,611	1,571	48,488	44,510
General and administrative	6,699	5,889	5,758	3,062	859	766	533	673	13,849	10,390

(2)

Acquisition fee ⁽³⁾										1,000	
Restructuring charge	559	659								559	659
Income from vessel operations	35,117	21,159	19,085	12,370	5,841	3,992	3,299	3,983	62,342	41,504	

- (1) Income from vessel operations for the three months ended March 31, 2014 excludes \$3.1 million from the *Voyageur Spirit* FPSO relating to a production shortfall during the period January 1, 2014 through to February 21, 2014 and a further \$0.4 million relating to unreimbursed vessel operating expenses. While under an interim agreement with the charterer, Teekay Corporation had indemnified the Partnership for these amounts which have effectively been treated as a reduction to the purchase price of the *Voyageur Spirit* (see note 7c). The unit was declared as on-hire commencing February 22, 2014.
- (2) Includes direct general and administrative expenses and indirect general and administrative expenses (allocated to each segment based on estimated use of corporate resources).
- (3) The towage segment has not been disaggregated as its results are not material other than a \$1.0 million fee associated with the acquisition of ALP Maritime Services B.V.. This fee was recognized in general and administrative in the consolidated statement of income for the three months ended March 31, 2014 (see note 14).

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(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data)

A reconciliation of total segment assets to total assets presented in the accompanying consolidated balance sheets is as follows:

	March 31, 2014	December 31, 2013
	\$	\$
Shuttle tanker segment	2,000,877	2,004,505
FPSO segment	1,281,758	1,303,229
FSO segment	104,753	102,452
Conventional tanker segment	145,196	144,723
Towage segment	48,814	
Unallocated:		
Cash and cash equivalents	222,990	219,126
Other assets	40,991	32,051
Consolidated total assets	3,845,379	3,806,086

5. Long-Term Debt

	March 31, 2014	December 31, 2013
	\$	\$
U.S. Dollar-denominated Revolving Credit Facilities due through 2018	714,018	743,494
Norwegian Kroner Bonds due through 2019	484,277	312,947
U.S. Dollar-denominated Term Loans due through 2018	183,536	188,854
U.S. Dollar-denominated Term Loans due through 2023	922,947	949,531
U.S. Dollar Bonds due through 2023	174,150	174,150
Total	2,478,928	2,368,976
Less current portion	748,055	806,009
Long-term portion	1,730,873	1,562,967

As at March 31, 2014, the Partnership had seven long-term revolving credit facilities, which, as at such date, provided for total borrowings of up to \$839.5 million, of which \$125.5 million was undrawn. The total amount available under the revolving credit facilities reduces by \$599.1 million (remainder of 2014), \$59.2 million (2015), \$121.9 million (2016), \$20.9 million (2017) and \$38.4 million (2018). Five of the revolving credit facilities are guaranteed by the Partnership and certain of its subsidiaries for all outstanding amounts and contain covenants that require the Partnership to maintain the greater of a minimum liquidity (cash, cash equivalents and undrawn committed revolving credit lines with at least six months to maturity) of at least \$75.0 million and 5.0% of the Partnership's total consolidated debt. Two revolving credit facilities are guaranteed by Teekay Corporation and contain covenants that require Teekay Corporation to maintain the greater of a minimum liquidity (cash and cash equivalents) of at least \$50.0 million and 5.0% of Teekay Corporation's total consolidated debt which has recourse to Teekay Corporation. The revolving credit facilities are collateralized by first-priority mortgages granted on 24 of the Partnership's vessels, together with other related security.

In January 2014, the Partnership issued NOK 1,000 million in senior unsecured bonds that mature in January 2019 in the Norwegian bond market. As of March 31, 2014, the carrying amount of the bonds was \$167.0 million. The interest payments on the bonds are based on NIBOR plus a margin of 4.25%. The Partnership entered into a cross currency swap to swap all interest and principal payments into USD, with the interest payments fixed at a rate of 6.28%, and the transfer of the principal amount fixed at \$162.2 million upon maturity in exchange for NOK 1,000 million (see note 8). The Partnership is applying to list the bonds on the Oslo Stock Exchange.

In January 2013, the Partnership issued in the Norwegian bond market NOK 1,300 million in senior unsecured bonds. The bonds were issued in two tranches maturing in January 2016 (NOK 500 million) and January 2018 (NOK 800 million). As at March 31, 2014, the carrying amount of the bonds was \$217.1 million. The bonds are listed on the Oslo Stock Exchange. Interest payments on the tranche maturing in 2016 are based on NIBOR plus a margin of 4.00%. Interest payments on the tranche maturing in 2018 are based on NIBOR plus a margin of 4.75%. The Partnership entered into cross currency rate swaps to swap all interest and principal payments into USD, with interest payments fixed at a rate of 4.80% on the tranche maturing in 2016 and 5.93% on the tranche maturing in 2018 and the transfer of the principal amount fixed at \$89.7 million upon maturity in exchange for NOK 500 million on the tranche maturing in 2016 and fixed at \$143.5 million upon maturity in exchange for NOK 800 million on the tranche maturing in 2018 (see note 8). As part of this bond issuance, the Partnership repurchased at a premium NOK 388.5 million of a then outstanding NOK 600 million bond set to mature in November 2013. In connection with this repurchase of bonds, the Partnership terminated a similar notional amount of the related cross currency swap (see note 8). The Partnership recorded a loss in relation to this repurchase of \$1.8 million in its consolidated statements of income for the three months ended March 31, 2013.

The Partnership has NOK 600 million of senior unsecured bonds that mature in January 2017 in the Norwegian bond market. As at March 31, 2014, the carrying amount of the bonds was \$100.2 million. The bonds are listed on the Oslo Stock Exchange. The interest payments on the bonds are based on NIBOR plus a margin of 5.75%. The Partnership entered into a cross currency rate swap to swap all interest and principal payments into USD, with the interest payments fixed at a rate of 7.49%, and the transfer of the principal amount fixed at \$101.4 million upon maturity in exchange for NOK 600 million (see note 8).

Table of Contents**TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES****NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data)**

As at March 31, 2014, six of the Partnership's 50% owned subsidiaries each had an outstanding term loan, which in the aggregate totaled \$183.5 million. The term loans reduce over time with quarterly and semi-annual payments and have varying maturities through 2018. These term loans are collateralized by first-priority mortgages on the six shuttle tankers to which the loans relate, together with other related security. As at March 31, 2014, the Partnership had guaranteed \$52.9 million of these term loans, which represents its 50% share of the outstanding term loans of five of these 50% owned subsidiaries. The other owner and Teekay Corporation have guaranteed \$91.8 million and \$38.8 million, respectively, of the outstanding term loans.

As at March 31, 2014, the Partnership had term loans outstanding for the shuttle tankers the *Amundsen Spirit*, the *Nansen Spirit*, the *Peary Spirit*, the *Scott Spirit*, the *Samba Spirit* and the *Lambada Spirit* and for the *Rio das Ostras*, the *Piranema Spirit* and the *Voyageur Spirit* FPSO units, which in aggregate totaled \$922.9 million. For the term loan for the *Amundsen Spirit* and the *Nansen Spirit*, one tranche reduces in semi-annual payments while the other tranche correspondingly is drawn up every six months with final bullet payments of \$29.0 million due in 2022 and \$29.1 million due in 2023, respectively. The *Peary Spirit*, the *Scott Spirit*, the *Samba Spirit*, the *Lambada Spirit*, the *Rio das Ostras*, the *Piranema Spirit* and the *Voyageur Spirit* term loans reduce over time with quarterly or semi-annual payments. These term loans have varying maturities through 2023 and are collateralized by first-priority mortgages on the vessels to which the loans relate, together with other related security. As at March 31, 2014, the Partnership had guaranteed \$531.5 million of these term loans and Teekay Corporation had guaranteed \$391.4 million.

As at March 31, 2014, the Partnership had outstanding \$174.2 million of ten-year senior unsecured bonds that mature in December 2023 and were issued in the second half of 2013 in a U.S. private placement market to finance the *Bossa Nova Spirit* and the *Sertanejo Spirit* shuttle tankers. The bonds accrue interest at a fixed combined rate of 4.96%. The bonds are collateralized by first-priority mortgages on the two vessels to which the bonds relate, together with other related security.

Interest payments on the revolving credit facilities and the term loans are based on LIBOR plus a margin. At March 31, 2014 and December 31, 2013, the margins ranged between 0.3% and 3.25%. The weighted-average effective interest rate on the Partnership's variable rate long-term debt as at March 31, 2014 was 2.9% (December 31, 2013 2.7%). This rate does not include the effect of the Partnership's interest rate swaps (see note 8).

The aggregate annual long-term debt principal repayments required to be made subsequent to March 31, 2014 are \$768.0 million (remainder of 2014), \$149.8 million (2015), \$285.4 million (2016), \$345.5 million (2017), \$350.5 million (2018), and \$579.7 million (thereafter).

The Partnership and a subsidiary of Teekay Corporation are borrowers under a loan arrangement and are jointly and severally liable for the obligations to the lender. The obligations resulting from long-term debt joint and several liability arrangements are measured at the sum of the amount the Partnership agreed to pay, on the basis of its arrangement with the co-obligor, and any additional amount the Partnership expects to pay on behalf of the co-obligor. As of March 31, 2014, this loan arrangement had an outstanding balance of \$81.5 million, of which \$46.5 million was the Partnership's obligation. The Partnership does not expect to pay any amount on behalf of the co-obligor.

Obligations under the Partnership's credit facilities are secured by certain vessels, and if the Partnership is unable to repay debt under the credit facilities, the lenders could seek to foreclose on those assets. The Partnership has one revolving credit facility that requires it to maintain a vessel value to drawn principal balance ratio of a minimum of 105%. As at March 31, 2014, this ratio was 143.0%. The vessel value used in this ratio is the appraised value prepared by the Partnership based on second hand sale and purchase market data. A further delay in the recovery of the conventional tanker market could negatively affect this ratio.

As at March 31, 2014, the Partnership and Teekay Corporation were in compliance with all covenants related to the credit facilities and long-term debt.

6. Restructuring Charge

During the three months ended March 31, 2014, the Partnership incurred \$0.6 million of restructuring charges related to the reflagging of one shuttle tanker which commenced in January 2014 and was completed in March 2014.

During the three months ended March 31, 2014 and 2013, the Partnership recognized restructuring charges of \$nil and \$0.7 million, respectively, relating to the reorganization of the Partnership's shuttle tanker marine operations which commenced in December 2012 and was completed in June 2013. The purpose of the restructuring was to create better alignment with the Partnership's marine operations resulting in a lower cost organization going forward.

As of March 31, 2014, restructuring liabilities of \$0.9 million were recorded in accrued liabilities on the consolidated balance sheet.

7. Related Party Transactions and Balances

- a) During the three months ended March 31, 2014, two conventional tankers, two shuttle tankers and two FSO units of the Partnership were employed on long-term time-charter-out contracts with subsidiaries of Teekay Corporation. During the first quarter of 2014, the long-term bareboat contracts employed by two conventional tankers of the Partnership with a joint venture in which Teekay Corporation has a 50% interest were novated under the same terms to a subsidiary of Teekay Corporation. The excess of the contractual rates over the market rates at the time of the novation, was \$0.1 million for the three months ended March 31, 2014 and is accounted for as an equity contribution from Teekay Corporation. During the first quarter of 2013, the long-term time-charter-out contract employed by one of the Partnership's conventional tankers with a subsidiary of Teekay Corporation was terminated. The Partnership received an early termination fee from Teekay Corporation of \$6.8 million in the first quarter of 2013, which is recorded in discontinued operations on the consolidated statement of income for the three months ended March 31, 2013. Teekay Corporation and its wholly-owned subsidiaries provide substantially all of the Partnership's commercial, technical, crew training, strategic, business development and administrative service

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needs. In addition, the Partnership reimburses the General Partner for expenses incurred by the General Partner that are necessary or appropriate for the conduct of the Partnership's business. Such related party transactions were as follows for the periods indicated:

	Three Months Ended March 31,	
	2014	2013
	\$	\$
Revenues ⁽¹⁾	17,330	18,813
Vessel operating expenses ⁽²⁾	9,648	9,847
General and administrative ⁽³⁾	8,288	6,508
Interest expense ⁽⁴⁾	111	58
Net income from related party transactions from discontinued operations ⁽⁵⁾		12,263

- (1) Includes revenue from long-term time-charter-out contracts and short-term time-charter-out contracts with subsidiaries or affiliates of Teekay Corporation, including management fees from ship management services provided by the Partnership to a subsidiary of Teekay Corporation.
 - (2) Includes ship management and crew training services provided by Teekay Corporation.
 - (3) Includes commercial, technical, strategic, business development and administrative management fees charged by Teekay Corporation and reimbursements to Teekay Corporation and our General Partner for costs incurred on the Partnership's behalf.
 - (4) Guarantee fee related to the final bullet payment of the *Piranema Spirit* FPSO debt facility guaranteed by Teekay Corporation.
 - (5) Related party transactions relating to three conventional tankers determined to be discontinued operations. This includes revenue from long-term time-charter-out contracts with subsidiaries or affiliates of Teekay Corporation, including the early termination fee described above, and crew training, commercial, technical, strategic and business development management fees charged by Teekay Corporation.
- b) At March 31, 2014, due from affiliates totaled \$19.7 million (December 31, 2013 \$15.2 million) and due to affiliates totaled \$80.2 million (December 31, 2013 \$121.9 million). Due to and from affiliates are non-interest bearing and unsecured, and are expected to be settled within the next fiscal year in the normal course of operations.
 - c) On May 2, 2013, the Partnership acquired from Teekay Corporation its 100% interest in Voyageur LLC, which owns the *Voyageur Spirit* FPSO unit, which operates on the Huntington Field in the North Sea under a five-year contract, plus up to 10 one-year extension options, with E.ON Ruhrgas UK GP Limited (or *E.ON*),

for an original purchase price of \$540.0 million. The purchase price was financed with the assumption of the \$230.0 million debt facility secured by the unit, \$270.0 million with cash (of which a partial prepayment of \$150.0 million was made to Teekay Corporation in February 2013) and the non-cash issuance of 1.4 million common units to Teekay Corporation, which had a value of \$40.0 million at the time Teekay Corporation offered to sell the unit to the Partnership.

On April 13, 2013, the *Voyageur Spirit* FPSO unit began production and on May 2, 2013, the Partnership acquired the unit from Teekay Corporation. Upon commencing production, the Partnership and its sponsor, Teekay Corporation, had a specified time period to receive final acceptance from the charterer, at which point the unit would commence full operations under the contract with E.ON. However, due to a defect encountered in one of its two gas compressors, the FPSO unit was unable to achieve final acceptance within the allowable timeframe, resulting in the FPSO unit being declared off-hire by the charterer retroactive to April 13, 2013.

On August 27, 2013, repairs to the defective gas compressor on the *Voyageur Spirit* FPSO were completed and the unit achieved full production capacity. On September 30, 2013, the Partnership entered into an interim agreement with E.ON whereby the Partnership was compensated for production beginning August 27, 2013 until the receipt of final acceptance by E.ON. Compensation was based on actual production relative to the operating capacity of the FPSO unit; however, any restrictions on production as a result of the charterer were included in this compensation. For the period from April 13, 2013 to December 31, 2013, Teekay Corporation has indemnified the Partnership a total of \$34.9 million for production shortfalls and unreimbursed repair costs. For the first quarter of 2014, Teekay Corporation indemnified the Partnership for a further \$3.1 million and \$0.4 million for production shortfalls and unrecovered repair costs to address the compressor issues, respectively. On April 4, 2014, the Partnership received the certificate of final acceptance from the charterer, which declared the unit on-hire retroactive to February 22, 2014.

Any amounts paid as indemnification from Teekay Corporation to the Partnership were effectively treated as a reduction in the purchase price paid by the Partnership for the FPSO unit. Any future compensation received by the Partnership from the charterer related to the indemnification period will reduce the amount of Teekay Corporation's indemnification to the Partnership. As at March 31, 2014, the \$540.0 million original purchase price of the *Voyageur Spirit* FPSO unit has effectively been reduced to \$505.8 million (\$275.8 million net of assumed debt of \$230.0 million) to reflect a total \$38.4 million indemnification amount from the date of first oil on April 13, 2013, partially offset by the excess value of \$4.3 million relating to the 1.4 million common units issued to Teekay Corporation on the date of closing of the transaction in May 2013 compared to the date Teekay Corporation offered to sell the unit to the Partnership. The excess of the purchase price (net of assumed debt) over the book value of the net assets of \$201.8 million has been accounted for as an equity distribution to Teekay Corporation of \$74.1 million.

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8. Derivative Instruments and Hedging Activities

The Partnership uses derivatives to manage certain risks in accordance with its overall risk management policies.

Foreign Exchange Risk

The Partnership economically hedges portions of its forecasted expenditures denominated in foreign currencies with foreign currency forward contracts. The Partnership has not designated, for accounting purposes, these foreign currency forward contracts as cash flow hedges.

As at March 31, 2014, the Partnership was committed to the following foreign currency forward contracts:

	Contract Amount in Foreign Currency (in thousands of U.S. Dollars) (thousands)	Fair Value / Carrying Amount of Asset (in thousands of U.S. Dollars) Non-hedge	Average Forward Rate⁽¹⁾	Expected Maturity 2014 2015 (in thousands of U.S. Dollars)
Norwegian Kroner	275,000	266	6.06	35,615 9,760
Norwegian Kroner	132,500	928	6.30	13,554 7,482
		1,194		49,169 17,242

(1) Average forward rate represents the contracted amount of foreign currency one U.S. Dollar will buy. The Partnership enters into cross currency swaps and pursuant to these swaps the Partnership receives the principal amount in Norwegian Kroner (or *NOK*) on the maturity date of the swap, in exchange for payment of a fixed U.S. Dollar amount. In addition, the cross currency swaps exchange a receipt of floating interest in NOK based on NIBOR plus a margin for a payment of U.S. Dollar fixed interest. The purpose of the cross currency swaps is to economically hedge the foreign currency exposure on the payment of interest and principal at maturity of the Partnership's Norwegian Kroner Bonds due through 2019. In addition, the cross currency swaps due from 2016 through 2019 economically hedge the interest rate exposure on the Norwegian Kroner Bonds due in 2016 through 2019. The Partnership has not designated, for accounting purposes, these cross currency swaps as cash flow hedges of its Norwegian Kroner Bonds due through 2019. As at March 31, 2014, the Partnership was committed to the following cross currency swaps:

**Fair Value /
Carrying**

Principal Amount	Principal Amount	Floating Rate Receivable			Fixed Rate Payable	Amount of	Remaining Term (years)
		Reference Rate	Margin	Asset (Liability)			
NOK	USD	Rate	Margin	Payable	(Liability)		
600,000	101,351	NIBOR	5.75%	7.49%	(3,690)	2.8	
500,000	89,710	NIBOR	4.00%	4.80%	(6,892)	1.8	
800,000	143,536	NIBOR	4.75%	5.93%	(10,090)	3.8	
1,000,000	162,200	NIBOR	4.25%	6.28%	2,794	4.8	
					(17,878)		

Interest Rate Risk

The Partnership enters into interest rate swaps, which exchange a receipt of floating interest for a payment of fixed interest, to reduce the Partnership's exposure to interest rate variability on its outstanding floating-rate debt. The Partnership has not designated, for accounting purposes, its interest rate swaps as cash flow hedges of its U.S. Dollar LIBOR-denominated borrowings.

As at March 31, 2014, the Partnership was committed to the following interest rate swap agreements:

	Interest Rate Index	Notional Amount \$	Fair Value / Carrying Amount of Assets (Liability) \$	Weighted-Average Remaining Term (years)	Fixed Interest Rate (%) ⁽¹⁾
U.S. Dollar-denominated interest rate swaps ⁽²⁾	LIBOR	800,000	(122,068)	8.6	4.7
U.S. Dollar-denominated interest rate swaps ⁽³⁾	LIBOR	864,345	(41,943)	6.1	2.6
		1,664,345	(164,011)		

(1) Excludes the margin the Partnership pays on its variable-rate debt, which as at March 31, 2014, ranged between 0.3% and 3.25%.

(2) Notional amount remains constant over the term of the swap.

(3) Principal amount reduces quarterly or semi-annually.

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As at March 31, 2014, the Partnership had multiple interest rate swaps and cross currency swaps governed by the same master agreement. Each of these master agreements provides for the net settlement of all swaps subject to that master agreement through a single payment in the event of default or termination of any one swap. The fair value of these interest rate swaps are presented on a gross basis in the Partnership's consolidated balance sheets. As at March 31, 2014, these interest rate swaps and cross currency swaps had an aggregate fair value asset amount of \$5.2 million and an aggregate fair value liability amount of \$161.7 million.

Tabular disclosure

The following table presents the location and fair value amounts of derivative instruments, segregated by type of contract, on the Partnership's balance sheets.

	Current Portion of Accounts Receivable	Derivative Assets	Derivative Assets	Accrued Liabilities	Current Portion of Derivative Liabilities	Derivative Liabilities
	\$	\$	\$	\$	\$	\$
As at March 31, 2014						
Foreign currency contracts		1,228	269		(303)	
Cross currency swaps		318	3,192	(8)	(543)	(20,837)
Interest rate swaps			8,707	(7,934)	(54,319)	(110,465)
		1,546	12,168	(7,942)	(55,165)	(131,302)
As at December 31, 2013						
Foreign currency contracts		213	4		(976)	(83)
Cross currency swaps	12	287			(311)	(25,421)
Interest rate swaps			10,319	(9,174)	(46,657)	(95,631)
	12	500	10,323	(9,174)	(47,944)	(121,135)

For the periods indicated, the following table presents the effective portion of gains (losses) on foreign currency forward contracts designated and qualifying as cash flow hedges that were (1) recognized in other comprehensive income, (2) recorded in accumulated other comprehensive income (or *AOCI*) during the term of the hedging relationship and reclassified to earnings, and (3) recognized in the ineffective portion of losses on derivative instruments designated and qualifying as cash flow hedges.

Balance Sheet (AOCI) Effective Portion	Three Months Ended March 31, 2014			Three Months Ended March 31, 2013		
	Effective Portion	Statement of Income		Effective Portion	Statement of Income	
		Ineffective Portion			Ineffective Portion	
\$	\$	\$	\$	\$	\$	\$
			Vessel operating expenses	6		Vessel operating expenses
			General and administrative expenses		(52)	(59) General and administrative expenses
				6	(52)	(59)

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Realized and unrealized (losses) gains of interest rate swaps and foreign currency forward contracts that are not designated for accounting purposes as cash flow hedges are recognized in earnings and reported in realized and unrealized losses on derivative instruments in the consolidated statements of income. The effect of the (losses) gains on these derivatives on the consolidated statements of income is as follows:

	Three Months Ended March 31,	
	2014	2013
	\$	\$
Realized (losses) gains relating to:		
Interest rate swaps	(14,063)	(14,623)
Foreign currency forward contracts	(497)	353
	(14,560)	(14,270)
Unrealized (losses) gains relating to:		
Interest rate swaps	(24,108)	14,971
Foreign currency forward contracts	2,036	(1,778)
	(22,072)	13,193
Total realized and unrealized losses on derivative instruments	(36,632)	(1,077)

Realized and unrealized gains (losses) of the cross currency swaps are recognized in earnings and reported, including the impact of the partial termination of a cross currency swap in connection with the repurchase of bonds described in note 5, in foreign currency exchange loss in the consolidated statements of income. The effect of the gain (loss) on cross currency swaps on the consolidated statements of income is as follows:

	Three Months Ended March 31,	
	2014	2013
	\$	\$
Realized gain on partial termination of cross-currency swap		6,800
Realized gains	16	725
Unrealized gains (losses)	7,575	(25,502)

Total realized and unrealized gains (losses) on cross currency swaps	7,591	(17,977)
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The Partnership is exposed to credit loss in the event of non-performance by the counterparties, all of which are financial institutions, to the foreign currency forward contracts and the interest rate swap agreements. In order to minimize counterparty risk, the Partnership only enters into derivative transactions with counterparties that are rated A- or better by Standard & Poor's or A3 or better by Moody's at the time of the transactions. In addition, to the extent possible and practical, interest rate swaps are entered into with different counterparties to reduce concentration risk.

9. Income Tax

The components of the provision for income tax are as follows:

	Three Months Ended March 31,	
	2014	2013
	\$	\$
Current	(1,253)	126
Deferred	(10)	108
Income tax (expense) recovery	(1,263)	234

10. Commitments and Contingencies

- a) On November 13, 2006, one of the Partnership's shuttle tankers, the *Navion Hispania*, collided with the *Njord Bravo*, an FSO unit, while preparing to load an oil cargo from the *Njord Bravo*. The *Njord Bravo* services the Njord field, which is operated by Statoil Petroleum AS (or *Statoil*) and is located off the Norwegian coast. At the time of the incident, Statoil was chartering the *Navion Hispania* from the Partnership. The *Navion Hispania* and the *Njord Bravo* both incurred damage as a result of the collision. In November 2007, Navion Offshore Loading AS (or *NOL*) and Teekay Navion Offshore Loading Pte Ltd. (or *TNOL*), subsidiaries of the Partnership, and Teekay Shipping Norway AS (or *TSN*), a subsidiary of Teekay Corporation, were named as co-defendants in a legal action filed by Norwegian Hull

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Club (the hull and machinery insurers of the *Njord Bravo*), several other insurance underwriters and various licensees in the *Njord* field. The Plaintiffs sought damages for vessel repairs, expenses for a replacement vessel and other amounts related to production stoppage on the field, totaling NOK 213,000,000 (approximately \$35.6 million).

In December 2011, the Stavanger District Court ruling in the first instance found that NOL was liable for damages except for damages related to certain indirect or consequential losses. The court also found that Statoil ASA was liable to NOL for the same amount of damages to NOL. As a result of this ruling, as at December 31, 2012, the Partnership reported a liability in the total amount of NOK 76,000,000 (approximately \$12.7 million) to the Plaintiffs and a corresponding receivable from Statoil ASA recorded in other long-term liabilities and other assets, respectively.

The Plaintiffs appealed the decision and the appellate court in June 2013 held that NOL, TNOL and TSN are jointly and severally responsible towards the Plaintiffs for all the losses as a result of the collision, plus interests accrued on the amount of damages. In addition, Statoil ASA was held not to be under an obligation to indemnify NOL, TNOL and TSN for the losses. NOL, TNOL and TSN were also held liable for legal costs associated with court proceedings. As a result of this recent judgment, in the second quarter of 2013, the Partnership recognized a liability in the amount of NOK 213,000,000 in respect of damages, NOK 66,000,000 in respect of interest and NOK 11,000,000 in respect of legal costs, totaling NOK 290,000,000 (approximately \$48.4 million), to the Plaintiffs recorded in accrued liabilities. The receivable from Statoil ASA previously recorded in other assets was reversed in the second quarter of 2013. In the fourth quarter of 2013, the Partnership recognized an additional liability of NOK 4,000,000 in respect of interest, bringing the total liability to NOK 294,000,000 (approximately \$49.1 million). The judgment rendered deals with liability only and the ultimate amount of damages may be reduced compared to the NOK 213,000,000 claimed by the Plaintiffs.

The Partnership and Teekay Corporation maintain protection and indemnity insurance for damages to the *Navion Hispania* and insurance for collision-related costs and claims. These insurance policies are expected to cover the costs related to this incident, including any costs not indemnified by Statoil, and thus a receivable of NOK 294,000,000 (approximately \$49.1 million) was concurrently recorded in accounts receivable, which equals the total cost of the claim. In addition, Teekay Corporation has agreed to indemnify the Partnership for any losses it may incur in connection with this incident.

In the fourth quarter of 2013, the insurer made payments directly to the Plaintiffs in full settlement of interest and partial settlement of legal costs and thus the Partnership, as at December 31, 2013, reduced its liability and related receivable to NOK 213,000,000 in respect of damages and approximately NOK 3,400,000 in respect of legal costs, totaling approximately NOK 216,400,000 (approximately \$36.1 million). No further payments were made in the first quarter of 2014.

- b) During 2010, an unrelated party contributed the *Randgrid* shuttle tanker to a subsidiary of the Partnership for a 33% equity interest in the subsidiary. The non-controlling interest owner in the subsidiary holds a put

option which, if exercised, would obligate the Partnership to purchase the non-controlling interest owner's 33% share in the entity for cash in accordance with a defined formula. The redeemable non-controlling interest is subject to remeasurement if the formulaic redemption amount exceeds the carrying value. No remeasurement was required as at March 31, 2014.

- c) In May 2013, the Partnership entered into an agreement with Statoil, on behalf of the field license partners, to provide an FSO unit for the Gina Krog oil and gas field located in the North Sea. The contract will be serviced by a new FSO unit that will be converted from the 1995-built shuttle tanker, the *Randgrid*, which the Partnership currently owns through a 67% owned subsidiary and will acquire full ownership of the vessel prior to its conversion. The FSO conversion project is expected to cost approximately \$277 million, including amounts reimbursable upon delivery of the unit relating to installation and mobilization, and the cost of acquiring the remaining 33% ownership interest in the *Randgrid* shuttle tanker. As at March 31, 2014, payments made towards this commitment totaled \$15.6 million. Following scheduled completion in early-2017, the newly converted FSO unit will commence operations under a three-year time-charter contract to Statoil, which includes 12 additional one-year extension options.
- d) In May 2013, the Partnership entered into a ten-year charter contract, plus extension options, with Salamander Energy plc (or *Salamander*) to supply a FSO unit in Asia. The Partnership is converting its 1993-built shuttle tanker, the *Navion Clipper*, into an FSO unit for an estimated fully built-up cost of approximately \$70 million (including reimbursable installation costs). As at March 31, 2014, payments made towards this commitment totaled \$30.5 million. The unit is expected to commence its charter contract with Salamander in the third quarter of 2014.

11. Total Capital and Net Income Per Common Unit

At March 31, 2014, a total of 72.1% of the Partnership's common units outstanding were held by the public. The remaining common units, as well as the 2% general partner interest, were held by a subsidiary of Teekay Corporation. All of the Partnership's Series A Preferred Units (defined below) outstanding are held by the public.

In 2013, the Partnership implemented a continuous offering program (or *COP*) under which the Partnership may issue new common units, representing limited partner interests, at market prices up to a maximum aggregate amount of \$100 million.

Net Income Per Common Unit

Limited partner's interest in net income per common unit basic is determined by dividing net income, after deducting the non-controlling interests and the General Partner's interest and the distributions on the Series A Preferred Units (defined below), by the weighted-average number of common units outstanding during the period. The accumulated distributions on the preferred units for the three months ended March 31, 2014 were \$2.7 million.

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The computation of limited partners' interest in net income per common unit—diluted assumes the exercise of all dilutive restricted units using the treasury stock method. The computation of limited partners' interest in net income per common unit—diluted does not assume such exercises as the effect would be anti-dilutive.

The General Partner's and common unitholders' interests in net income are calculated as if all net income was distributed according to the terms of the Partnership's partnership agreement, regardless of whether those earnings would or could be distributed. The partnership agreement does not provide for the distribution of net income; rather, it provides for the distribution of available cash, which is a contractually defined term that generally means all cash on hand at the end of each quarter less the amount of cash reserves established by the Partnership's board of directors to provide for the proper conduct of the Partnership's business, including reserves for maintenance and replacement capital expenditure and anticipated capital requirements and any accumulated distributions on the Series A Preferred Units (defined below). Unlike available cash, net income is affected by non-cash items such as depreciation and amortization, unrealized gains and losses on derivative instruments and unrealized foreign currency translation gains and losses.

The Partnership allocates the limited partners' interest in net income, including both distributed and undistributed net income, between continuing operations and discontinued operations based on the proportion of net income (loss) from continuing and discontinued operations to total net income.

During the quarters ended March 31, 2014 and 2013, cash distributions exceeded \$0.4025 per common unit and, consequently, the assumed distributions of net income resulted in the use of the increasing percentages to calculate the General Partner's interest in net income for the purposes of the net income per common unit calculation. For more information on the increasing percentages to calculate the General Partner's interest in net income, please refer to the Partnership's Annual Report on Form 20-F for the year ended December 31, 2013.

Pursuant to the partnership agreement, allocations to partners are made on a quarterly basis.

Preferred Units

Pursuant to the partnership agreement, distributions on the Series A Cumulative Redeemable Preferred Units (or *Series A Preferred Units*) to preferred unitholders are cumulative from the date of original issue and are payable quarterly in arrears, when, as and if declared by the board of directors of the General Partner. At any time on or after April 30, 2018, the Series A Preferred Units may be redeemed by the Partnership at a redemption price of \$25.00 per unit plus an amount equal to all accumulated and unpaid distributions to the date of redemption. These units are listed on the New York Stock Exchange.

12. Unit Based Compensation

During the three months ended March 31, 2014, a total of 9,482 common units, with an aggregate value of \$0.3 million, were granted and issued to the non-management directors of the General Partner as part of their annual compensation for 2014.

The Partnership grants restricted unit awards as incentive-based compensation to certain employees of Teekay Corporation's subsidiaries that provide services to the Partnership. During March 2014 and 2013, the Partnership granted 68,153 and 63,309 restricted units, respectively, with a fair value of \$2.1 million and \$1.8 million, respectively, based on the Partnership's closing unit price on the grant date. Each restricted unit is equal in value to one of the Partnership's common units plus reinvested distributions from the grant date to the vesting date. The restricted units vest equally over three years from the grant date. Any portion of a restricted unit award that is not vested on the date of a recipient's termination of service is cancelled, unless their termination arises as a result of the recipient's retirement and, in this case, the restricted unit awarded will continue to vest in according with the vesting schedule. Upon vesting, the value of the restricted units is paid to each grantee in the form of common units or cash. During the three months ended March 31, 2014, a total of 50,075 restricted stock units with a fair value of \$1.6 million vested and the amount paid to the grantees was made by issuing 6,584 common units and by paying \$0.1 million in cash. During the three months ended March 31, 2013, a total of 6,742 restricted stock units with a fair value of \$0.2 million vested. During the three months ended March 31, 2014 and 2013, the Partnership recorded unit based compensation expense of \$1.3 million and \$0.2 million, respectively, in general and administrative expenses in the Partnership's consolidated statements of income. As of March 31, 2014 and 2013, liabilities relating to cash settled restricted unit awards of \$1.0 million and \$nil, respectively, were recorded in accrued liabilities on the Partnership's consolidated balance sheets.

13. Discontinued Operations

The operations of the *Leyte Spirit*, the *Poul Spirit* and the *Gotland Spirit* prior to being considered discontinued operations, were reported within the conventional tanker segment. The *Leyte Spirit*, which was written down in 2012, was sold in the first quarter of 2013. In the first and second quarters of 2013, the *Poul Spirit* and the *Gotland Spirit*, respectively, were written down to their estimated fair values in conjunction with the termination of their long-term time-charter-out contracts with a subsidiary of Teekay Corporation. The Partnership received an early termination fee of \$6.8 million relating to the *Poul Spirit* from Teekay Corporation in the first quarter of 2013, which is recorded in discontinued operations. The *Poul Spirit* was further written down upon sale in the second quarter of 2013 and a gain was recognized upon the sale of the *Gotland Spirit* in the third quarter of 2013. The estimated fair value for each of the three vessels was determined using appraised values. The following table summarizes the net loss from discontinued operations related to these three vessels for the period presented in the consolidated statements of income:

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	Three Months Ended March 31, 2013
	\$
REVENUES	12,310
OPERATING EXPENSES	
Voyage expenses	278
Vessel operating expenses	1,791
Depreciation and amortization	839
General and administrative	275
Write-down of vessel	11,247
Total operating expenses	14,430
Loss from vessel operations	(2,120)
OTHER ITEMS	
Interest expense	(52)
Foreign currency exchange loss	(2)
Other expense net	(1)
Total other items	(55)
Net loss from discontinued operations	(2,175)

14. Acquisition of ALP Maritime Services B.V.

On March 14, 2014, the Partnership acquired 100% of the shares of ALP Maritime Services B.V. (or *ALP*), a Netherlands-based provider of long-haul ocean towage and offshore installation services to the global offshore oil and gas industry. Concurrently with this transaction, the Partnership and ALP entered into an agreement with Niigata Shipbuilding & Repair of Japan for the construction of four state-of-the-art SX-157 Ulstein Design ultra-long distance towing and anchor handling vessel newbuildings. These vessels will be equipped with dynamic positioning capability and are scheduled for delivery in 2016. The Partnership is committed to acquire these newbuildings for a total cost of approximately \$258 million. As at March 31, 2014, payments made towards these commitments totaled \$46.4 million and the remaining payments required to be made under these newbuilding contracts are \$16.0 million (balance of 2014), \$73.1 million (2015) and \$122.5 million (2016). The Partnership intends to continue financing the newbuilding installments through its existing liquidity and expects to secure long-term debt financing for these vessels prior to their scheduled deliveries in 2016.

The Partnership acquired ALP for a purchase price of \$2.6 million, which was paid in cash, and also entered into an arrangement to pay additional compensation to three former shareholders of ALP if certain requirements are satisfied. This contingent compensation consists of \$2.4 million, which is payable upon the delivery and employment of ALP's four newbuildings scheduled throughout 2016, and a further amount of up to \$2.6 million, which is payable if ALP's annual operating results from 2017 to 2021 meet certain targets. The Partnership has the option to pay up to one half of this compensation through the issuance of common units of the Partnership. Each of the contingent compensation amounts are payable only if the three shareholders are employed by ALP at the time performance conditions are met. Compensation costs will be recorded under general and administrative expenses in the Partnership's consolidated statements of income. The Partnership also incurred a \$1.0 million fee associated with the acquisition which has been recognized in general and administrative expenses in March 2014.

This acquisition of ALP and related newbuilding order represents the Partnership's entrance into the long-haul ocean towage and offshore installation services business. This acquisition allows the Partnership to combine its infrastructure and access to capital with ALP's experienced management team to further grow this niche business that is in an adjacent sector to the Partnership's FPSO and shuttle tanker businesses. The acquisition of ALP was accounted for using the purchase method of accounting, based upon preliminary estimates of fair value.

The following table summarizes the preliminary estimates of fair values of the ALP assets acquired and liabilities assumed by the Partnership on the acquisition date.

Table of Contents**TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES****NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data)

<i>(in thousands of U.S. dollars)</i>	As at March 14, 2014
	\$
ASSETS	
Cash and cash equivalents	294
Other current assets	404
Advances on newbuilding contracts	164
Other assets long-term	395
Goodwill (towage segment)	2,032
Total assets acquired	3,289
LIABILITIES	
Current liabilities	387
Other long-term liabilities	286
Total liabilities assumed	673
Net assets acquired	2,616
Consideration	2,616

The goodwill recognized in connection with the ALP acquisition is attributable primarily to the assembled workforce of ALP, including their experience, skills and abilities. Operating results of ALP are reflected in these financial statements commencing March 14, 2014, the effective date of acquisition. From the date of acquisition to March 31, 2014, the Partnership recognized \$nil million of revenue and \$1.1 million of net loss resulting from this acquisition. The following table shows comparative summarized consolidated pro forma financial information for the Partnership for the three months ended March 31, 2014 and 2013, giving effect to the Partnership's acquisition of ALP as if it had taken place on January 1, 2013:

<i>(in thousands of U.S dollars, except per unit data)</i>	Pro Forma Three Months ended March 31, 2014	Pro Forma Three Months ended March 31, 2013
	\$	\$
Revenues	259,371	215,144
Net income	8,793	22,041
	0.01	0.21

Limited partners interest in net income per common unit basic		
Limited partners interest in net income per common unit diluted	0.01	0.21

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TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES

MARCH 31, 2014

PART I FINANCIAL INFORMATION

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

We are an international provider of marine transportation, oil production and storage services to the offshore oil industry focusing on the fast-growing, deep-water offshore oil regions of the North Sea and Brazil. We were formed in August 2006 by Teekay Corporation, a leading provider of marine services to the global oil and natural gas industries, to further develop its operations in the offshore market. We operate shuttle tankers, floating production, storage and off-loading (or *FPSO*) units, floating storage and off-take (or *FSO*) units, conventional crude oil tankers and towage tankers. Our current fleet consists of 35 shuttle tankers (including two chartered-in vessels and one HiLoad Dynamic Positioning (or *DP*) unit scheduled to complete operational testing in the second quarter of 2014), five FPSO units, six FSO units (including one committed FSO conversion unit), four long-haul towing and anchor handling vessel newbuildings scheduled for delivery in 2016 and four conventional oil tankers, in which our interests range from 50% to 100%.

SIGNIFICANT DEVELOPMENTS

Acquisition of Logitel

In May 2014, we entered into a letter of intent to acquire Logitel Offshore Holdings Ltd. (or *Logitel*), a Norway-based company focused on the high-end floating accommodation market. Logitel owns two floating accommodation units (or *FAUs*), which are based on the Sevan Marine ASA (or *Sevan*) cylindrical hull design, currently under construction at the COSCO (Nantong) Shipyard (or *COSCO*) in China, and has options with COSCO to order up to an additional six FAUs. The first committed FAU has secured a three-year, fixed-rate charter contract, plus extension options, with Petrobras Brasileiro SA (or *Petrobras*) in Brazil and is scheduled for delivery in early-2015. We expect to enter into a charter contract for the second FAU prior to its scheduled delivery in late-2015. The agreement with COSCO for the committed FAUs includes a payment schedule favorable to us, in which the majority of the purchase price is due upon delivery. We intend to finance the Logitel acquisition and the initial newbuilding payments through our existing liquidity and expect to secure long-term debt financing for the units prior to their scheduled deliveries. We expect the proposed acquisition to be finalized in the third quarter of 2014.

Acquisition of ALP and Newbuilding Order

In March 2014, we acquired ALP Maritime Services B.V. (or *ALP*), a Netherlands-based provider of long-haul ocean towage and offshore installation services to the global offshore oil and gas industry. ALP currently provides these services through a fleet of third-party owned vessels. As part of the transaction, we and ALP entered into an agreement with Niigata Shipbuilding & Repair of Japan for the construction of four state-of-the-art SX-157 Ulstein Design ultra-long distance towing and anchor handling vessel newbuildings, which will be equipped with dynamic positioning capability, for a fully built-up cost of approximately \$261 million, which includes the cost of acquiring ALP. These newbuildings will be capable of ultra-long distance towing and offshore unit installation and decommissioning of large floating exploration, production and storage units, including FPSO units, floating liquefied

natural gas (or *FLNG*) units and floating drill rigs. We intend to continue financing the newbuilding installments through our existing liquidity and expect to secure long-term debt financing for these vessels prior to their scheduled deliveries in 2016.

We acquired ALP for a purchase price of \$2.6 million, which we paid in cash and we also entered into an arrangement to pay additional compensation to three former shareholders of ALP if certain requirements are satisfied. This contingent compensation consists of \$2.4 million, which is payable upon the delivery and employment of ALP's four newbuildings scheduled throughout 2016, and a further amount of up to \$2.6 million, which is payable if ALP's annual operating results from 2017 to 2021 meet certain targets. We have the option to pay up to one half of this contingent compensation through the issuance of our common units. The contingent compensation amounts are payable only if the three shareholders are employed by ALP at the time the performance conditions are met. We also incurred a \$1.0 million fee associated with the acquisition which has been recognized in general and administrative expenses in March 2014.

This acquisition of ALP and related newbuilding order represents our entrance into the long-haul ocean towage and offshore installation services business, which combines our infrastructure and access to capital with ALP's experienced management team to further grow this niche business that is a natural complement to our existing offshore business.

Shuttle Contracts

In December 2013, we were awarded a six-year shuttle tanker contract of affreightment, with extension options up to an additional four years, with BG Group plc, which will service the Knarr oil and gas field in the North Sea. The expected start date for the shuttle tanker contract of affreightment coincides with the expected start-up of the *Petrojarl Knarr* FPSO in the North Sea in the fourth quarter of 2014.

In September 2013, we acquired a 2010-built HiLoad DP unit from Remora AS (or *Remora*), a Norway-based offshore marine technology company, for a total purchase price of approximately \$55 million, including modification costs. The HiLoad DP unit is currently undergoing operational testing, which is expected to be completed during the second quarter of 2014. Upon completion of the testing, the unit is expected to commence operations under a ten-year time-charter contract with Petrobras in Brazil. Under the terms of an agreement between Remora and us, we have a right of first refusal to acquire any future HiLoad DP projects developed by Remora. In July 2013, Remora was awarded a contract by BG E&P Brasil Ltd. to perform a front end engineering and design study to develop the next generation of HiLoad DP units. The design, which is based on the main parameters of the first generation design, is expected to include new features, such as increased engine power and the capability to maneuver vessels larger than Suezmax conventional tankers.

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***Voyageur Spirit* FPSO Acquisition**

On August 27, 2013, repairs to the defective gas compressor on the *Voyageur Spirit* FPSO unit were completed and the unit achieved full production capacity. Since that time, we have been receiving full rate under the charter contract as though the unit was producing at full capacity either directly from the charterer or through the indemnification arrangement with Teekay Corporation. On April 4, 2014, we received the certificate of final acceptance from the charterer, which declared the unit on-hire retroactive to February 22, 2014.

Up to February 22, 2014, we have been indemnified by Teekay Corporation for certain lost revenues and certain unrecovered vessel operating expenses relating to the full operation of the *Voyageur Spirit* FPSO. Any indemnification amounts from Teekay Corporation to us have been effectively treated as a reduction in the purchase price paid by us to Teekay Corporation for the *Voyageur Spirit* FPSO. During the first quarter of 2014, our indemnification effectively resulted in a \$3.5 million reduction in the purchase price of the *Voyageur Spirit* FPSO. For the period from the date of first oil on April 13, 2013 to receipt of the certificate of final acceptance from E.ON Ruhrgas UK GP Limited (or *E.ON*) on February 22, 2014, Teekay Corporation indemnified us for a total \$38.4 million relating to the *Voyageur Spirit* FPSO.

FSO Contracts

In May 2014, we entered into a ten-year contract extension with Apache Energy for the *Dampier Spirit* FSO unit, which operates on the Stag oil field offshore Western Australia. As part of the extension, the FSO unit is expected to enter into drydock for a total cost of approximately \$11 million for capital upgrades during the second quarter of 2014. Under the new contract, the unit is expected to earn approximately \$5.7 million in annual cash flow from vessel operations.

In May 2013, we entered into an agreement with Statoil Petroleum AS (or *Statoil*), on behalf of the field license partners, to provide an FSO unit for the Gina Krog oil and gas field located in the North Sea. The contract will be serviced by a new FSO unit that will be converted from the 1995-built shuttle tanker, *Randgrid*, which we currently own through a 67%-owned subsidiary. The FSO conversion project is expected to be completed for a gross capital cost of approximately \$277 million, including amounts reimbursable upon delivery of the unit relating to installation and mobilization, and the cost of acquiring the remaining 33% ownership interest in the *Randgrid* shuttle tanker. Following scheduled completion in early-2017, the newly converted FSO unit will commence operations under a three-year time-charter contract to Statoil, which also includes 12 additional one-year extension options.

In May 2013, we entered into a ten-year charter contract, plus extension options, with Salamander Energy plc (or *Salamander*) to supply an FSO unit in Asia. We are converting our 1993-built shuttle tanker, the *Navion Clipper*, into an FSO unit for an estimated fully built-up cost of approximately \$70 million (including reimbursable installation costs). The unit is expected to commence its charter contract with Salamander in the third quarter of 2014.

Bond Issuance

In January 2014, we issued in the Norwegian bond market NOK 1,000 million in senior unsecured bonds, maturing in January 2019. The aggregate principal amount of the bonds was equivalent to \$162.2 million and all interest and principal payments have been swapped into U.S. dollars at a fixed rate of 6.28%. The net proceeds from the bond offering were used for general partnership purposes. We are applying to list the bonds on the Oslo Stock Exchange.

Potential Additional Shuttle Tanker, FSO and FPSO Projects

Pursuant to an omnibus agreement that we entered into in connection with our initial public offering in December 2006, Teekay Corporation is obligated to offer to us its interest in certain shuttle tankers, FSO units and FPSO units Teekay Corporation owns or may acquire in the future, provided the vessels are servicing contracts with remaining durations of greater than three years. We may also acquire other vessels that Teekay Corporation may offer us from time to time and we intend to pursue direct acquisitions from third parties and new offshore projects.

Pursuant to the omnibus agreement and subsequent agreements, Teekay Corporation is obligated to offer to sell to us the *Petrojarl Foinaven* FPSO unit, an existing unit owned by Teekay Corporation and operating under a long-term contract in the North Sea, subject to approvals required from the charterer. The purchase price for the *Petrojarl Foinaven* would be based on fair market value.

In May 2011, Teekay Corporation entered into a joint venture agreement with Odebrecht Oil & Gas S.A. (a member of the Odebrecht group) (or *Odebrecht*) to jointly pursue FPSO projects in Brazil. Odebrecht is a well-established Brazil-based company that operates in the engineering and construction, petrochemical, bioenergy, energy, oil and gas, real estate and environmental engineering sectors, with over 120,000 employees and a presence in over 20 countries. Through the joint venture agreement, Odebrecht became a 50 percent partner in the *Cidade de Itajai* (or *Itajai*) FPSO project and Teekay Corporation is currently working with Odebrecht on other FPSO project opportunities that, if awarded, may result in offers to us to acquire Teekay Corporation's interests in such projects, pursuant to the omnibus agreement.

In June 2011, Teekay Corporation entered into a contract with BG Norge Limited to provide a harsh weather FPSO unit to operate in the North Sea. The contract will be serviced by a newbuilding FPSO unit, the *Petrojarl Knarr*, which is being constructed by Samsung Heavy Industries for a fully built-up cost of approximately \$1 billion. Pursuant to the omnibus agreement, Teekay Corporation is obligated to offer to us its interest in the *Petrojarl Knarr* FPSO project at Teekay Corporation's fully built-up cost within a year after the commencement of the charter, which commencement is expected to occur in the fourth quarter of 2014.

Teekay Corporation owns three additional FPSO units, the *Hummingbird Spirit* FPSO, the *Petrojarl Banff* FPSO and the *Petrojarl I* FPSO, which may also be offered to us in the future pursuant to the omnibus agreement.

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There are a number of factors that should be considered when evaluating our historical financial performance and assessing our future prospects and we use a variety of financial and operational terms and concepts when analyzing our results of operations. These can be found in Part I, Item 5 Operating and Financial Review and Prospects in our Annual Report on Form 20-F for the year ended December 31, 2013. In accordance with United States generally accepted accounting principles (or *GAAP*), we report gross revenues in our income statements and include voyage expenses among our operating expenses. However, shipowners often base economic decisions regarding the deployment of their vessels upon anticipated time charter equivalent (or *TCE*) rates, and industry analysts typically measure bulk shipping freight rates in terms of TCE rates. This is because under time charters and bareboat charters the customer usually pays the voyage expenses while under voyage charters and contracts of affreightment the shipowner usually pays the voyage expenses, which typically are added to the hire rate at an approximate cost. Accordingly, the discussion of revenue below focuses on net revenues (i.e. revenues less voyage expenses) and TCE rates of our four reportable segments where applicable. TCE rates represent net revenues divided by revenue days. Please read Item 1 Financial Statements: Note 4 Segment Reporting.

We manage our business and analyze and report our results of operations on the basis of four business segments: the shuttle tanker segment, the FPSO segment, the FSO segment, and the conventional tanker segment, each of which are discussed below. We have a new business segment, the towage segment, as a result of our acquisition of ALP in March 2014; however, given that ALP's results for the period were not significant, other than the \$1.0 million acquisition fee, the segment is not separately discussed below in this report.

Shuttle Tanker Segment

As at March 31, 2014, our shuttle tanker fleet consisted of 33 vessels that operate under fixed-rate contracts of affreightment, time charters and bareboat charters, one shuttle tanker in lay-up as a conversion candidate and the Hilo DP unit, which is scheduled to complete operational testing late in the second quarter of 2014. Of these 35 shuttle tankers, six were owned through 50% owned subsidiaries, three through a 67% owned subsidiary and two were chartered-in. The remaining vessels are owned 100% by us. All of these shuttle tankers, with the exception of the HiLoad DP unit, provide transportation services to energy companies, primarily in the North Sea and Brazil. Our shuttle tankers service the conventional spot tanker market from time to time. One of these shuttle tankers, the *Randgrid*, is committed to a conversion into an FSO unit upon the expiry of its existing shuttle tanker charter contract in 2015.

The following table presents our shuttle tanker segment's operating results for the three months ended March 31, 2014 and 2013, and compares its net revenues (which is a non-GAAP financial measure) for the three months ended March 31, 2014 and 2013 to revenues, the most directly comparable GAAP financial measure, for the same periods. The following table also provides a summary of the changes in calendar-ship-days by owned and chartered-in vessels for our shuttle tanker segment:

(in thousands of U.S. dollars, except calendar-ship-days and percentages)	Three Months Ended March 31,		
	2014	2013	% Change
Revenues	153,180	130,350	17.5
Voyage expenses	31,706	22,294	42.2
Net revenues	121,474	108,056	12.4

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Vessel operating expenses	40,406	37,967	6.4
Time-charter hire expense	11,412	14,777	(22.8)
Depreciation and amortization	27,281	27,605	(1.2)
General and administrative ⁽¹⁾	6,699	5,889	13.8
Restructuring charge	559	659	(15.2)
Income from vessel operations	35,117	21,159	66.0
Calendar-Ship-Days			
Owned Vessels	2,880	2,635	9.3
Chartered-in Vessels	278	371	(25.1)
Total	3,158	3,006	5.1

(1) Includes direct general and administrative expenses and indirect general and administrative expenses (allocated to the shuttle tanker segment based on estimated use of corporate resources). See the discussion under **Other Operating Results** below.

The average size of our owned shuttle tanker fleet increased for the three months ended March 31, 2014 compared to the same period last year, primarily due to the delivery of the four newbuilding shuttle tankers (or the *BG Shuttle Tankers*) to us during 2013, partially offset by the sale of the *Basker Spirit* in January 2013, and the in-progress conversion of the *Navion Clipper* to an FSO unit. Included in calendar-ship-days is one owned shuttle tanker that has been in lay-up since May 2012 following its redelivery to us upon maturity of its time-charter-out contract in April 2012.

The average size of our chartered-in shuttle tanker fleet decreased for the three months ended March 31, 2014 compared to the same period last year, primarily due to the redelivery of the *Karen Knutsen* in January 2014 and the *Grena* in November 2013.

Net Revenues. Net revenues increased for the three months ended March 31, 2014 from the same period last year, primarily due to:

an increase of \$19.0 million for the three months ended March 31, 2014, due to the commencement of the ten-year time-charter contracts of the four BG Shuttle Tankers during 2013 and early 2014;

an increase of \$5.2 million for the three months ended March 31, 2014, due to more opportunities to trade excess shuttle tanker capacity in the conventional tanker spot market;

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an increase of \$0.8 million for the three months ended March 31, 2014, due to an increase in revenues in our bareboat fleet from an increase in rates as provided in certain contracts; and

an increase of \$0.5 million for the three months ended March 31, 2014, due to an increase in reimbursable bunker expenses;

partially offset by

a net decrease of \$9.3 million for the three months ended March 31, 2014, due to fewer revenue days from the redelivery of three vessels to us in July 2013, January 2014 and February 2014, as they completed their time-charter-out agreements, partially offset by an increase in revenues in our contract of affreightment fleet, an increase in revenues in our time-chartered-out fleet from entering into new contracts and an increase in rates as provided in certain contracts;

a decrease of \$1.6 million for the three months ended March 31, 2014, due to fewer opportunities to trade excess shuttle tanker capacity in short-term offshore projects; and

a decrease of \$1.0 million for the three months ended March 31, 2014, due to more repair off-hire days in our time-chartered-out fleet compared to the same period last year.

Vessel Operating Expenses. Vessel operating expenses increased for the three months ended March 31, 2014 compared to the same period last year, primarily due to:

an increase of \$3.7 million for the three months ended March 31, 2014, due to the commencement of the charter contracts for the four BG Shuttle Tankers during 2013 and the first quarter of 2014;

an increase of \$1.0 million for the three months ended March 31, 2014, due to an increase in costs related to services, spares and repairs; and

an increase of \$0.5 million for the three months ended March 31, 2014, due to an increase in crew training expenses;

partially offset by

a decrease of \$1.2 million for the three months ended March 31, 2014, due to a decrease in ship management fees in our contract of affreightment and time-charter fleet associated with the reorganization of our onshore marine operations that occurred in 2013;

a decrease of \$0.9 million in crew and manning costs for the three months ended March 31, 2014, primarily due to the timing of bonus payments; and

a decrease of \$0.7 million for the three months ended March 31, 2014, relating to the lay-up of one of our shuttle tankers, the *Navion Clipper*, since February 2013, which is currently being converted to an FSO unit. *Time-Charter Hire Expense*. Time-charter hire expense decreased for the three months ended March 31, 2014 compared to the same period last year, primarily due to:

a decrease of \$7.1 million for the three months ended March 31, 2014, due to the redelivery of the *Karen Knutsen* in January 2014 and the *Grena* in November 2013; partially offset by

an increase of \$3.8 million for the three months ended March 31, 2014, due to increased spot in-chartering. *Restructuring Charges*. Restructuring charges were \$0.6 million for the three months ended March 31, 2014, resulting from the reflagging of one of our shuttle tankers. Restructuring charges were \$0.7 million for the three months ended March 31, 2013, resulting from a reorganization of marine operations to create better alignment within the shuttle tanker business unit to create a reduced-cost organization going forward.

FPSO Segment

As at March 31, 2014, our FPSO fleet consisted of the *Petrojarl Varg*, the *Cidade de Rio das Ostras* (or *Rio das Ostras*), the *Piranema Spirit* and the *Voyageur Spirit* FPSO units, all of which we own 100%, and a 50% interest in the *Itajai* FPSO unit. We acquired the *Voyageur Spirit* FPSO unit and our interest in the *Itajai* FPSO unit from Teekay Corporation in May 2013 and June 2013, respectively. We use the FPSO units to provide production, processing and storage services to oil companies operating offshore oil field installations. These services are typically provided under long-term, fixed-rate FPSO contracts, some of which also include certain incentive compensation based on the level of oil production and other operational measures. Historically, the utilization of FPSO units and other vessels in the North Sea, where the *Petrojarl Varg* and *Voyageur Spirit* operate, is higher in the winter months, as favorable weather conditions in the summer months provide opportunities for repairs and maintenance to our vessels and the offshore oil platforms, which generally reduces oil production.

The following table presents our FPSO segment's operating results for the three months ended March 31, 2014 and 2013 and also provides a summary of the calendar-ship-days for our FPSO segment. The table excludes the results of the *Itajai* FPSO unit, which is accounted for under the equity method.

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(in thousands of U.S. dollars, except calendar-ship-days and percentages)	Three Months Ended March 31,		
	2014	2013	% Change
Revenues	83,137	57,685	44.1
Vessel operating expenses	40,391	29,501	36.9
Depreciation and amortization	17,903	12,752	40.4
General and administrative ⁽¹⁾	5,758	3,062	88.0
Income from vessel operations	19,085	12,370	54.3
Calendar-Ship-Days			
Owned Vessels	360	270	33.3

(1) Includes direct general and administrative expenses and indirect general and administrative expenses (allocated to the FPSO segment based on estimated use of corporate resources). See the discussion under Other Operating Results below.

Revenues. Revenues increased for the three months ended March 31, 2014 compared to the same period last year, primarily due to:

an increase of \$27.2 million for the three months ended March 31, 2014, relating to the acquisition of the *Voyageur Spirit* FPSO unit; partially offset by

a decrease of \$1.2 million for the three months ended March 31, 2014, due to the strengthening of the U.S. Dollar against the Norwegian Kroner compared to the same period last year; and

a decrease of \$1.0 million for the three months ended March 31, 2014, due to the *Rio das Ostras* earning only a 95% standby rate while it was being relocated to a new oil field in the first quarter of 2014.

Teekay Corporation has indemnified us for lost revenue from the *Voyageur Spirit* being off-hire since the unit began operations on April 13, 2013. Please see Item 1 Financial Statements: Note 7(c). The indemnification amount was \$3.1 million for the three months ended March 31, 2014. This has been recorded in equity as an adjustment to the purchase price we paid for the FPSO unit.

Vessel Operating Expenses. Vessel operating expenses increased for the three months ended March 31, 2014 from the same period last year, primarily due to:

an increase of \$13.9 million for the three months ended March 31, 2014, due to the acquisition of the *Voyageur Spirit* FPSO unit; and

an increase of \$1.8 million for the three months ended March 31, 2014, due to higher crew and manning costs mainly relating to the *Petrojarl Varg* due to higher crew salaries; partially offset by

a decrease of \$2.1 million for the three months ended March 31, 2014, due to the strengthening of the U.S. Dollar against the Norwegian Kroner compared to the same period last year;

a decrease of \$2.0 million for the three months ended March 31, 2014, due to lower maintenance costs relating to the *Piranema Spirit* and *Petrojarl Varg* compared to the same period last year; and

a decrease of \$0.7 million and for the three months ended March 31, 2014, due to lower ship management costs relating to the *Petrojarl Varg*, *Rio das Ostras* and *Piranema Spirit*.

Teekay Corporation has indemnified us for vessel operating costs associated with unrecovered repair costs from the *Voyageur Spirit* since the unit began operations on April 13, 2013. The indemnification amount was \$0.4 million for the three months ended March 31, 2014. This has been recorded in equity as an adjustment to the purchase price we paid for the FPSO unit.

Depreciation and Amortization Expense. Depreciation and amortization expense increased for the three months ended March 31, 2014 from the same period last year, primarily due to the acquisition of the *Voyageur Spirit* FPSO unit during the second quarter of 2013.

FSO Segment

As at March 31, 2014, our FSO fleet consisted of five units that operate under fixed-rate time charters or fixed-rate bareboat charters, in which our ownership interests range from 89% to 100%, and one shuttle tanker, the *Navion Clipper*, which is currently being converted into an FSO unit, in which we have 100% interest. We have committed one shuttle tanker, the *Randgrid*, to conversion into an FSO unit upon the expiry of its existing shuttle tanker charter contract in 2015. FSO units provide an on-site storage solution to oil field installations that have no oil storage facilities or that require supplemental storage. Our revenues and vessel operating expenses for the FSO segment are affected by fluctuations in currency exchange rates, as a significant component of revenues are earned and vessel operating expenses are incurred in Norwegian Kroner and Australian Dollars for certain vessels. The strengthening or weakening of the U.S. Dollar relative to the Norwegian Kroner and Australian Dollar may result in significant decreases or increases, respectively, in our revenues and vessel operating expenses.

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The following table presents our FSO segment's operating results for the three months ended March 31, 2014 and 2013, and compares its net revenues (which is a non-GAAP financial measure) for the three months ended March 31, 2014 and 2013 to revenues, the most directly comparable GAAP financial measure, for the same periods. The following table also provides a summary of the changes in calendar-ship-days for our FSO segment:

(in thousands of U.S. dollars, except calendar-ship-days and percentages)	Three Months Ended March 31,		
	2014	2013	% Change
Revenues	14,289	15,140	(5.6)
Voyage expenses (recoveries)	23	(485)	(104.7)
Net revenues	14,266	15,625	(8.7)
Vessel operating expenses	5,873	8,285	(29.1)
Depreciation and amortization	1,693	2,582	(34.4)
General and administrative ⁽¹⁾	859	766	12.1
Income from vessel operations	5,841	3,992	46.3
Calendar-Ship-Days			
Owned Vessels	540	450	20.0

(1) Includes direct general and administrative expenses and indirect general and administrative expenses (allocated to the FSO segment based on estimated use of corporate resources). See the discussion under Other Operating Results below.

The average number of our FSO units for the three months ended March 31, 2014 increased compared to the same period last year due to the commencement of the conversion of the *Navion Clipper* shuttle tanker to an FSO unit in April 2013.

Net Revenues. Net revenues decreased for the three months ended March 31, 2014, compared to the same period last year, primarily due to:

a decrease of \$0.9 million for the three months ended March 31, 2014, primarily due to the timing of vessel operating expense reimbursements on the *Dampier Spirit* and the appreciation of the U.S. Dollar against the Australian Dollar compared to the same period last year; and

a decrease of \$0.6 million for the three months ended March 31, 2014, due to a recovery of expenses in 2013 relating to the 2012 drydocking of the *Navion Saga* and the appreciation of the U.S. Dollar against the Norwegian Kroner compared to the same period last year.

Vessel Operating Expenses. Vessel operating expenses decreased for the three months ended March 31, 2014 compared to the same period last year, primarily due to:

a decrease of \$1.0 million for the three months ended March 31, 2014, relating to expenditures on engineering studies completed to support our FSO tenders in the first quarter of 2013; and

a decrease of \$0.8 million for the three months ended March 31, 2014, relating to lower crew costs and the timing of services, spares and insurance for the *Dampier Spirit* primarily due to the appreciation of the U.S Dollar against the Australian Dollar compared to the same period last year.

Depreciation and Amortization Expense. Depreciation and amortization expense decreased for the three months ended March 31, 2014 from the same period last year primarily due to an extension of the useful lives of the *Pattani Spirit* and the *Apollo Spirit* due to the extension in the charter period for these units.

Table of Contents**Conventional Tanker Segment**

As at March 31, 2014, we owned 100% interests in two Aframax conventional crude oil tankers (which operate under fixed-rate time charters with Teekay Corporation), and two vessels (that have additional equipment for lightering) which operate under fixed-rate bareboat charters with a 100% owned subsidiary of Teekay Corporation.

The 2013 results in the table below excludes three additional conventional tankers as they were determined to be discontinued operations. During the first quarter of 2013, we sold a vessel and we terminated the long-term time-charter-out contract employed by one of our conventional tankers with a subsidiary of Teekay Corporation, which was sold in the second quarter of 2013. A third conventional tanker on contract to Teekay Corporation was sold in the third quarter of 2013. We received an early termination fee from Teekay Corporation of \$6.8 million in the first quarter of 2013, which is recorded in discontinued operations.

The following table presents our conventional tanker segment's operating results for the three months ended March 31, 2014 and 2013, and compares its net revenues (which is a non-GAAP financial measure) for the three months ended March 31, 2014 and 2013 to revenues, the most directly comparable GAAP financial measure, for the same periods. The following table also provides a summary of the changes in calendar-ship-days by owned vessels for our conventional tanker segment:

(in thousands of U.S. dollars, except calendar-ship-days and percentages)	Three Months Ended March 31,		
	2014	2013	% Change
Revenues	8,628	8,937	(3.5)
Voyage expenses	1,725	1,139	51.4
Net revenues	6,903	7,798	(11.5)
Vessel operating expenses	1,460	1,571	(7.1)
Depreciation and amortization	1,611	1,571	2.5
General and administrative ⁽¹⁾	533	673	(20.8)
Income from vessel operations	3,299	3,983	(17.2)
Calendar-Ship-Days			
Owned Vessels	360	360	

(1) Includes direct general and administrative expenses and indirect general and administrative expenses (allocated to the conventional tanker segment based on estimated use of corporate resources). See the discussion under "Other Operating Results" below.

Net Revenues. Net revenues decreased for the three months ended March 31, 2014, from the same period last year, primarily due to lower reimbursed bunkers.

Other Operating Results

General and Administrative Expenses. General and administrative expenses increased to \$14.8 million for the three months ended March 31, 2014, from \$10.4 million for the same period last year, mainly due to the acquisition of the *Voyageur Spirit* FPSO unit during the second quarter of 2013, a \$1.0 million fee relating to the acquisition of ALP

Maritime Services B.V., the delivery of the four BG Shuttle Tankers during 2013, and an increase in restricted unit awards, partially offset by cost savings due to the reorganization of marine operations within our shuttle tanker business unit completed in 2013.

Interest Expense. Interest expense increased to \$18.9 million for the three months ended March 31, 2014 from \$11.6 million for the same period last year, primarily due to:

an increase of \$6.0 million for the three months ended March 31, 2014, due to borrowings under new debt facilities relating to the *Voyageur Spirit* FPSO and the four BG Shuttle Tankers that delivered during the last three quarters of 2013; and

a net increase of \$1.5 million for the three months ended March 31, 2014, primarily from the issuance of NOK 1,000 million senior unsecured bonds in January 2014, partially offset by the repurchase of NOK 388.5 million of the NOK 600 million senior unsecured bond issue during the first quarter of 2013 and the remaining NOK 211.5 million bonds that matured in November 2013;
partially offset by

a decrease of \$0.6 million for the three months ended March 31, 2014, due to lower balances on all other borrowings compared to the same period last year.

Realized and Unrealized Losses on Derivatives. Net realized and unrealized losses on derivatives were \$36.6 million for the three months ended March 31, 2014, compared to \$1.1 million for the same period last year.

During the three months ended March 31, 2014 and 2013, we had interest rate swap agreements with aggregate average outstanding notional amounts of approximately \$1.7 billion and \$1.5 billion, respectively, with average fixed rates of approximately 3.6% and 4.3%, respectively. Short-term variable benchmark interest rates during these periods were generally 0.8% or less and, as such, we incurred realized losses of \$14.1 million and \$14.6 million during the three months ended March 31, 2014 and 2013, respectively, under the interest rate swap agreements.

During the three months ended March 31, 2014 and 2013, we recognized unrealized losses on our interest rate swaps of \$24.1 million and unrealized gains of \$15.0 million, respectively. The unrealized losses for the three months ended March 31, 2014 resulted from \$38.2 million of unrealized losses relating to decreases in long-term LIBOR benchmark interest rates relative to the prior quarter, offset by the transfer of \$14.1 million of previously recognized unrealized losses to realized losses, related to actual cash settlements. The unrealized gains for the three months ended March 31, 2013 resulted from the transfer of \$14.6 million of previously unrecognized losses to realized losses, related to actual cash settlements, and an additional \$0.4 million of unrealized gains relating to increases in long-term LIBOR benchmark interest rates relative to the prior quarter.

Equity Income. Equity income was \$3.7 million for the three months ended March 31, 2014 relating to the *Itajai* FPSO unit in which we acquired a 50 percent interest from Teekay Corporation in June 2013.

Foreign Currency Exchange Losses. Foreign currency exchange losses were \$0.8 million for the three months ended March 31, 2014 compared to \$3.6 million for the same period last year. Our foreign currency exchange losses, substantially all of which are unrealized, are due primarily to the relevant period-end revaluation of Norwegian Kroner-denominated monetary assets and liabilities for financial reporting purposes and the realized and unrealized gains and losses on our cross currency swaps. Gains on Norwegian Kroner-denominated monetary liabilities reflect a stronger U.S. Dollar against the Norwegian Kroner on the date of revaluation or settlement compared to the rate in

effect at the beginning of the period. Losses on Norwegian Kroner-denominated monetary liabilities reflect a weaker U.S. Dollar against the Norwegian Kroner on the date of revaluation or settlement compared to the rate in effect at the beginning of the period. For the three months ended March 31, 2014, foreign currency exchange losses include realized gains of \$nil (2013 gains of \$0.7 million) and unrealized gains of \$7.6 million (2013 losses of \$25.5 million) on the cross currency swaps and unrealized losses of \$9.1 million (2013 gains of \$24.0 million) on the revaluation of the Norwegian Kroner denominated debt. There were additional realized and unrealized foreign exchange gains of \$0.8 million for the three months ended March 31, 2014 (2013 loss of \$3.1 million) on all other monetary assets and liabilities. During the three months ended March 31, 2013, we repurchased NOK 388.5 million of the then outstanding NOK 600 million senior unsecured bond issue that matured in November 2013. Associated with this, we recorded \$6.6 million of realized losses on the repurchased bonds, and recorded \$6.8 million of realized gains on the termination of the associated cross currency swap.

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Loss on Bond Repurchase. Loss on bond repurchase was \$1.8 million for the three months ended March 31, 2013. The loss represents a 2.5% premium paid for the repurchase of NOK 388.5 million of the then outstanding NOK 600 million senior unsecured bond issue that matured in November 2013.

Income Tax (Expense) Recovery. Income tax expense was \$1.3 million for the three months ended March 31, 2014 compared to a \$0.2 million recovery for the same period last year. The increase to income tax expense for the three months ended March 31, 2014 was primarily due to the non-deductibility of certain intercompany interest expense in our Norwegian entities commencing in 2014 due to a change in tax laws, and tax adjustments relating to the *Rio das Ostras* Brazilian entity during the first quarters of 2014 and 2013.

Net Loss from Discontinued Operations. Net loss from discontinued operations was \$2.2 million for the three months ended March 31, 2013 related to our sales of the *Leyte Spirit*, the *Poul Spirit* and the *Gotland Spirit* during the first, second and third quarters of 2013, respectively.

If these vessels described above were not classified as discontinued operations, the results of the operations of these vessels would have been reported within the conventional tanker segment.

During the first quarter of 2013, we terminated the long-term time-charter-out contract employed by the *Poul Spirit* with a subsidiary of Teekay Corporation. We received an early termination fee from Teekay Corporation of \$6.8 million during the three months ended March 31, 2013. In addition, we recorded a write-down of \$11.2 million on the *Poul Spirit* during the three months ended March 31, 2013.

Liquidity and Capital Resources

Liquidity and Cash Needs

Our business model is to employ our vessels on fixed-rate contracts with major oil companies, typically with original terms between three to ten years. The operating cash flow our vessels generate each quarter, excluding a reserve for maintenance capital expenditures, is generally paid out to our common unitholders within approximately 45 days after the end of each quarter. Our primary short-term liquidity needs are to pay quarterly distributions on our outstanding common and Series A preferred units, payment of operating expenses, dry docking expenditures, debt service costs and to fund general working capital requirements. We anticipate that our primary sources of funds for our short-term liquidity needs will be cash flows from operations. We believe that our existing cash and cash equivalents and undrawn long-term borrowings, in addition to all other sources of cash including cash from operations, will be sufficient to meet our existing liquidity needs for at least the next 12 months.

Our long-term liquidity needs primarily relate to expansion and maintenance capital expenditures and debt repayment. Expansion capital expenditures primarily represent the purchase or construction of vessels to the extent the expenditures increase the operating capacity or revenue generated by our fleet, while maintenance capital expenditures primarily consist of dry docking expenditures and expenditures to replace vessels in order to maintain the operating capacity or revenue generated by our fleet. Our primary sources of funds for our long-term liquidity needs are from cash from operations, long-term bank borrowings and other debt or equity financings, or a combination thereof. Consequently, our ability to continue to expand the size of our fleet is dependent upon our ability to obtain long-term bank borrowings and other debt, as well as raising equity.

Our revolving credit facilities and term loans are described in Item 1 Financial Statements: Note 5 Long-Term Debt. They contain covenants and other restrictions typical of debt financing secured by vessels that restrict the ship-owning subsidiaries from incurring or guaranteeing indebtedness; changing ownership or structure, including mergers,

consolidations, liquidations and dissolutions; making dividends or distributions if we are in default; making capital expenditures in excess of specified levels; making certain negative pledges and granting certain liens; selling, transferring, assigning or conveying assets; making certain loans and investments; or entering into a new line of business. Certain of our revolving credit facilities and term loans include financial covenants. Should we not meet these financial covenants, the lender may accelerate the repayment of the revolving credit facilities and term loans, thus having an impact on our short-term liquidity requirements. We have one revolving credit facility that requires us to maintain a vessel value to drawn principal balance ratio of a minimum of 105%. As at March 31, 2014, this ratio was 143%. The vessel value used in this ratio is the appraised value prepared by us based on second hand sale and purchase market data. A further delay in the recovery of the conventional tanker market could negatively affect this ratio. As at March 31, 2014, we and our affiliates were in compliance with all covenants relating to the revolving credit facilities and term loans.

As at March 31, 2014, our total cash and cash equivalents were \$223.0 million, compared to \$219.1 million at December 31, 2013. Our total liquidity, including cash, cash equivalents and undrawn long-term borrowings, was \$348.5 million as at March 31, 2014, compared to \$331.0 million as at December 31, 2013. The increase in liquidity was primarily due to the proceeds from the issuance in January 2014 of NOK 1,000 million senior unsecured bonds, partially offset by: our acquisition in March 2014 of 100% of the shares of ALP Maritime Services B.V. and the first installment on the four ALP towage vessels; a reduction in the amount available for borrowing under our revolving credit facilities; and the scheduled repayment or prepayment of outstanding term loans.

As at March 31, 2014, we had a working capital deficit of \$615.9 million, compared to a working capital deficit of \$720.6 million at December 31, 2013. As at March 31, 2014, the working capital deficit included \$170.2 million of term loans, \$569.8 million of revolving credit facilities, \$54.3 million of interest rate swap liabilities and \$80.2 million due to affiliates. The current portion of long-term debt decreased mainly due to the refinancing of a term facility during the three months ended March 31, 2014. In October 2014, we have \$410.4 million of balloon payments due on two revolving credit facilities. Both of these revolving credit facilities bear interest at rates that are considered below market rates relative to the current market levels and, as such, we intend to refinance these balloon payments by entering into a new credit facility closer to the date of their maturities. In September 2014, we have a \$15.7 million balloon payment due on one of our revolving credit facilities, which we intend on refinancing with a new loan facility closer to the date this facility comes due. Our due to affiliates balance decreased mainly due to repayments made during the first quarter of 2014. We expect to manage our working capital deficit primarily with net operating cash flow generated in 2014 and, to a lesser extent, with new and existing undrawn revolving credit facilities and term loans.

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The passage of any climate control legislation or other regulatory initiatives that restrict emissions of greenhouse gases could have a significant financial and operational impact on our business, which we cannot predict with certainty at this time. Such regulatory measures could increase our costs related to operating and maintaining our vessels and require us to install new emission controls, acquire allowances or pay taxes related to our greenhouse gas emissions, or administer and manage a greenhouse gas emissions program. In addition, increased regulation of greenhouse gases may, in the long term, lead to reduced demand for oil and reduced demand for our services.

Cash Flows. The following table summarizes our sources and uses of cash for the periods presented:

(in thousands of U.S. dollars)	Three Months Ended March 31,	
	2014	2013
Net cash flow from operating activities	19,572	46,347
Net cash flow from financing activities	51,953	78,957
Net cash flow used for investing activities	(67,661)	(158,842)

Operating Cash Flows.

Net cash flow from operating activities decreased to \$19.6 million for the three months ended March 31, 2014, from \$46.3 million for the same period in 2013 due primarily to a \$31.7 million decrease in changes in non-cash working capital items, a \$10.8 million increase in vessel operating expenses, a \$9.9 million decrease in income from discontinued operations, a \$7.0 million increase in net interest expense, a \$4.5 million increase in general and administrative expenses, a \$4.2 million increase in dry-docking expenditures, a \$1.7 million increase in net deferred mobilization costs and a \$1.4 million increase in current income taxes, partially offset by a \$36.4 million increase in net revenue, a \$3.4 million decrease in time charter hire expense, a \$3.0 million increase of realized foreign currency exchange gains and other items and a \$1.8 million decrease in loss on bond repurchase expenses.

The \$31.7 million decrease in non-cash working capital items for the three months ended March 31, 2014 compared to the same period last year is primarily due to the timing of settlements with related parties, partially offset by the timing of payments made to vendors and the timing of payments received from customers.

For a further discussion of changes in income statement items described above for our four reportable segments, please read [Results of Operations](#).

Financing Cash Flows.

We use our revolving credit facilities to finance capital expenditures and for general partnership purposes. Occasionally we will do this until longer-term financing is obtained, at which time we typically use all or a portion of the proceeds from the longer-term financings to prepay outstanding amounts under the revolving credit facilities. Our proceeds from long-term debt, net of debt issuance costs and prepayments of long-term debt were \$136.6 million for the three months ended March 31, 2014, and \$139.5 million for the same period in 2013.

Net proceeds from the issuance of long-term debt decreased for the three months ended March 31, 2014, mainly due to the proceeds from the issuance of NOK 1,300 million unsecured bonds issued during the three months ended March 31, 2013, (of which a portion was used to repurchase NOK 388.5 million of existing bonds, to repay existing revolving credit facility debt and for general partnership purposes), partially offset by the proceeds from the issuance of NOK 1,000 million unsecured bonds issued during three months ended March 31, 2014, which were used for general partnership purposes.

We actively manage the maturity profile of our outstanding financing arrangements. Our scheduled repayments of long-term debt increased to \$38.0 million for the three months ended March 31, 2014, from \$23.0 million for the same period in 2013.

Cash distributions paid by our subsidiaries to non-controlling interests during the three months ended March 31, 2014 and 2013 totaled \$3.6 million and \$nil, respectively. Cash distributions paid by us to our common unitholders and our general partner, with respect to our common units, and our Series A preferred unitholders during the three months ended March 31, 2014 and 2013 were \$53.6 million and \$44.2 million, respectively. The increase in distributions to our common and preferred unitholders was attributed to: two increases in our cash distribution to common unitholders, one commencing with the cash distributions paid in the second quarter of 2013 and the other commencing with the cash distribution paid in the first quarter of 2014, of \$0.0128 per unit and \$0.0131 per unit, respectively, or approximately 2.5% each; an increase in the number of common units resulting from the 5.5 million (including our general partner's 2% proportionate capital contribution) common units issued during 2013; and the issuance of 6.0 million Series A preferred units in 2013. The increase in the 2013 cash distribution coincided with our acquisition of the *Voyageur Spirit* FPSO unit. The increase in the 2014 cash distribution coincided with the completion of deliveries of the four BG Shuttle Tankers. Subsequent to March 31, 2014, cash distributions of \$50.9 million on our outstanding common units and general partner interest related to the three months ended March 31, 2014 were declared and paid on May 9, 2014. Subsequent to March 31, 2014, cash distributions for Series A preferred units relating to the first quarter of 2014 were declared and paid on May 15, 2014 and totaled \$2.7 million.

Investing Cash Flows.

During the three months ended March 31, 2014, net cash flow used for investing activities was \$67.7 million, primarily relating to the expenditures for vessels and equipment (including the first installment of \$46.2 million on the four newbuilding ALP towage vessels and \$20.6 million on various other vessel additions) and the \$2.3 million acquisition of 100% of the shares of ALP, partially offset by the scheduled lease payments of \$1.4 million received from the leasing of our volatile organic compound emissions equipment and direct financing lease assets.

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During the three months ended March 31, 2013, net cash flow used for investing activities was \$158.8 million, primarily relating to: a partial prepayment of \$150.0 million to Teekay Corporation in connection with the acquisition of the *Voyageur Spirit* FPSO unit, which we received interest at a rate of LIBOR plus a margin of 4.25% on the prepaid funds to Teekay Corporation until we acquired the FPSO unit on May 2, 2013; expenditures for vessels and equipment, including an installment payment of \$11.2 million on one of the four newbuilding BG Shuttle Tankers; and \$12.6 million on various other vessel additions; partially offset by \$13.3 million in proceeds from the sale of the *Basker Spirit* and the *Leyte Spirit*, both in the first quarter of 2013, and the scheduled lease payments of \$1.7 million received from the leasing of our volatile organic compound emissions equipment and direct financing lease assets.

Contractual Obligations and Contingencies

The following table summarizes our long-term contractual obligations as at March 31, 2014:

	Total	Balance of 2014	2015 and 2016	2017 and 2018	Beyond 2018
(in millions of U.S. Dollars)					
U.S. Dollar-Denominated Obligations					
Long-term debt ⁽¹⁾	1,994.6	768.0	351.7	462.2	412.7
Chartered-in vessels (Operating leases)	27.2	20.3	6.9		
Acquisition of newbuildings ⁽²⁾	211.6	16.0	195.6		
Conversion of FSO units ⁽³⁾	300.9	71.8	229.1		
Norwegian Kroner-Denominated Obligations					
Long-term debt ⁽⁴⁾	484.3		83.5	233.8	167.0
Total contractual obligations	3,018.6	876.1	866.8	696.0	579.7

- (1) Excludes expected interest payments of \$27.8 million (remainder of 2014), \$53.5 million (2015 and 2016), \$33.1 million (2017 and 2018) and \$33.1 million (beyond 2018). Expected interest payments are based on LIBOR, plus margins which ranged between 0.3% and 3.25% as at March 31, 2014. The expected interest payments do not reflect the effect of related interest rate swaps that we have used as an economic hedge of certain of our variable rate debt.
- (2) Relates to the acquisition of four towage and anchor handling newbuildings. Please read Item 1 Financial Statements: Note 14 Acquisition of ALP Maritime Services B.V.
- (3) Includes amounts reimbursable upon delivery of the units relating to installation and mobilization costs, and the costs of acquiring the remaining 33% ownership interest in the *Randgrid* shuttle tanker. Please read Item 1 Financial Statements: Note 10 (c) and (d) Commitments and Contingencies.
- (4) Excludes expected interest payments of \$23.5 million (remainder of 2014), \$58.4 million (2015 and 2016), \$31.3 million (2017 and 2018) and \$0.9 million (beyond 2018). Expected interest payments are based on NIBOR, plus margins which ranged between 4.00% and 5.75% as at March 31, 2014. The expected interest payments do not reflect the effect of related interest rate swaps and cross currency swaps that we have used as an economic hedge of certain of our variable rate debt.

Critical Accounting Estimates

We prepare our consolidated financial statements in accordance with GAAP, which require us to make estimates in the application of our accounting policies based on our best assumptions, judgments and opinions. On a regular basis, management reviews the accounting policies, assumptions, estimates and judgments to ensure that our consolidated financial statements are presented fairly and in accordance with GAAP. However, because future events and their effects cannot be determined with certainty, actual results could differ from our assumptions and estimates and such differences could be material. Accounting estimates and assumptions discussed in this section of our Annual Report on Form 20-F are those that we consider to be the most critical to an understanding of our financial statements, because they inherently involve significant judgments and uncertainties. For a description of our material accounting policies, please read Part I, Item 5 Operating and Financial Review and Prospects in our Annual Report on Form 20-F for the year ended December 31, 2013. As at March 31, 2014, there were no significant changes to accounting estimates or assumptions from those discussed in the Form 20-F.

At March 31, 2014, the shuttle tanker and towage segments had goodwill attributable to them. Based on conditions that existed at March 31, 2014, we do not believe that there is a reasonable possibility that the goodwill attributable to these reporting units might be impaired for the remainder of the year. However, certain factors that impact this assessment are inherently difficult to forecast and, as such, we cannot provide any assurance that an impairment will or will not occur in the future. An assessment for impairment involves a number of assumptions and estimates that are based on factors that are beyond our control. These are discussed in more detail in the following section entitled Forward-Looking Statements .

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FORWARD-LOOKING STATEMENTS

This Report on Form 6-K contains certain forward-looking statements (as such term is defined in Section 27A of the Securities Exchange Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended) concerning future events and our operations, performance and financial condition, including, in particular, statements regarding:

our future growth prospects;

results of operations and revenues and expenses;

offshore and tanker market fundamentals, including the balance of supply and demand in the offshore and tanker market and spot tanker charter rates;

future capital expenditures and availability of capital resources to fund capital expenditures;

offers of shuttle tankers, FSOs and FPSOs units and related contracts from Teekay Corporation and our accepting the offers;

acquisitions from third parties and obtaining offshore projects, that we or Teekay Corporation bid on or may be awarded;

delivery dates, financing and estimated costs for newbuildings and acquisitions, including the HiLoad DP unit, FAUs and towage vessels;

the timing of the HiLoad DP unit commencing its 10-year charter contract with Petrobras;

the timing and cost of converting the *Navion Clipper* into an FSO unit and the timing of commencing its 10-year charter contract with Salamander;

the timing and certainty of completing the acquisition of Logitel and the timing of one of the FAUs commencing its three-year charter contract and our expectations as to the chartering of the other FAU;

the cost of converting the *Randgrid* into an FSO unit, the timing of commencing its three-year charter contract with Statoil and the cost and certainty of our acquisition of the remaining 33% ownership interest in the *Randgrid* shuttle tanker;

insurance coverage and indemnification for costs related to the collision between the *Navion Hispania* and the *Njord Bravo*;

vessel operating and crewing costs for vessels;

our entering into joint ventures or partnerships with companies;

the commencement of service of newbuildings or existing vessels;

the effect of the *Dampier Spirit* FSO contract extension on our cash flow from vessel operations;

the duration of dry dockings;

the future valuation of goodwill;

our liquidity needs;

our compliance with covenants under our credit facilities;

our ability to refinance our revolvers in 2014;

our hedging activities relating to foreign exchange, interest rate and spot market risks;

the ability of the counterparties for our derivative contracts to fulfill their contractual obligations; and

our exposure to foreign currency fluctuations, particularly in Norwegian Kroner.

Forward-looking statements include, without limitation, any statement that may predict, forecast, indicate or imply future results, performance or achievements, and may contain the words believe, anticipate, expect, estimate, project, will be, will continue, will likely result, plan, intend or words or phrases of similar meanings. These statements involve known and unknown risks and are based upon a number of assumptions and estimates that are inherently subject to significant uncertainties and contingencies, many of which are beyond our control. Actual results may differ materially from those expressed or implied by such forward-looking statements. Important factors that could cause actual results to differ materially include, but are not limited to: changes in production of oil from offshore oil fields; changes in the demand for offshore oil transportation, production and storage services; greater or less than anticipated levels of vessel newbuilding orders or greater or less than anticipated rates of vessel scrapping; changes in trading patterns; changes in our expenses; the timing of implementation of new laws and regulations; potential inability to implement our growth strategy; competitive factors in the markets in which we operate; potential for early termination

of long-term contracts and our potential inability to renew or replace long-term contracts; loss of any customer, time charter or vessel; shipyard production, conversion or vessel delivery delays; the inability of the joint venture between Teekay Corporation and Odebrecht to secure new Brazil FPSO projects that may be offered for sale to us; failure to obtain required approvals by the Conflicts Committee of our general partner to

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acquire other vessels or offshore projects from Teekay Corporation or third parties; our potential inability to raise financing to purchase additional vessels; our exposure to currency exchange rate fluctuations; changes to the amount of proportion of revenues and expenses denominated in foreign currencies; potential inability to negotiate and complete the proposed Logitel acquisition or to obtain charters or financing related to the FAUs; and other factors detailed from time to time in our periodic reports filed with the SEC, including our Annual Report on Form 20-F for the year ended December 31, 2013. We do not intend to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with respect thereto or any change in events, conditions or circumstances on which any such statement is based.

Table of Contents**TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES****MARCH 31, 2014****PART I FINANCIAL INFORMATION****ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK****Interest Rate Risk**

We are exposed to the impact of interest rate changes primarily through our floating-rate borrowings that require us to make interest payments based on LIBOR or NIBOR. Significant increases in interest rates could adversely affect operating margins, results of operations and our ability to service our debt. From time to time, we use interest rate swaps to reduce our exposure to market risk from changes in interest rates. The principal objective of these contracts is to minimize the risks and costs associated with our floating-rate debt.

We are exposed to credit loss in the event of non-performance by the counterparties to the interest rate swap agreements. In order to minimize counterparty risk, we only enter into derivative transactions with counterparties that are rated A- or better by Standard & Poor's or A3 or better by Moody's at the time of the transactions. In addition, to the extent possible and practical, interest rate swaps are entered into with different counterparties to reduce concentration risk.

The tables below provide information about financial instruments as at March 31, 2014 that are sensitive to changes in interest rates. For long-term debt, the table presents principal payments and related weighted-average interest rates by expected contractual maturity dates. For interest rate swaps, the table presents notional amounts and weighted-average interest rates by expected contractual maturity dates.

	Balance of 2014	Expected Maturity Date					Total	Fair Value Liability Rate ⁽¹⁾	
		2015	2016	2017	2018	There- after			
Long-Term Debt:									
Variable Rate (\$U.S.) ⁽²⁾	768.0	149.8	201.9	245.3	216.9	412.7	1,994.6	1,962.9	2.0%
Variable Rate (NOK) ⁽³⁾			83.5	100.2	133.6	167.0	484.3	495.4	6.3%
Interest Rate Swaps:									
Contract Amount ⁽⁴⁾	291.5	286.4	156.9	128.9	137.7	662.9	1,664.3	164.0	3.6%
Average Fixed Pay Rate	3.3%	3.7%	3.2%	1.2%	1.1%	4.7%	3.6%		

(1) Rate refers to the weighted-average effective interest rate for our debt, including the margin paid on our floating-rate debt and the average fixed pay rate for interest rate swaps. The average fixed pay rate for interest

rate swaps excludes the margin paid on the floating-rate debt, which as of March 31, 2014 ranged between 0.3% and 3.25% based on LIBOR and between 4.00% and 5.75% based on NIBOR.

- (2) Interest payments on U.S. Dollar-denominated debt and interest rate swaps are based on LIBOR.
- (3) Interest payments on NOK-denominated debt and interest rate swaps are based on NIBOR.
- (4) The average variable receive rate for interest rate swaps is set quarterly at the 3-month LIBOR or semi-annually at the 6-month LIBOR.

Foreign Currency Fluctuation Risk

Our functional currency is U.S. dollars because virtually all of our revenues and most of our operating costs are in U.S. Dollars. We incur certain vessel operating expenses and general and administrative expenses in foreign currencies, the most significant of which is the Norwegian Kroner and, to a lesser extent, Australian Dollars, Brazilian Reals, British Pounds, Euros and Singapore Dollars. There is a risk that currency fluctuations will have a negative effect on the value of cash flows.

We may continue to seek to hedge certain of our currency fluctuation risks in the future. At March 31, 2014, we were committed to the following foreign currency forward contracts:

	Contract Amount in Foreign Currency (thousands)	Average Forward Rate ⁽¹⁾	Expected Maturity 2014 2015		Fair Value / Carrying Amount of Asset (in thousands of U.S. Dollars) Non-hedge
Norwegian Kroner	275,000	6.06	35,615	9,760	266
Norwegian Kroner	132,500	6.30	13,554	7,482	928
			49,169	17,242	1,194

- (1) Average forward rate represents the contracted amount of foreign currency one U.S. Dollar will buy.

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We incur interest expense on our NOK-denominated bonds. We have entered into cross currency swaps to economically hedge the foreign exchange risk on the principal and interest for these bonds. Please read Item 1 Financial Statements: Note 8 Derivative Instruments and Hedging Activities.

As at March 31, 2014, we were committed to the following cross currency swaps:

Principal Amount NOK (thousands)	Principal Amount USD	Floating Rate Receivable		Fixed Rate Payable	Fair Value / Carrying	Remaining Term (years)
		Reference Rate	Margin		Amount of Asset (Liability) (Thousands of U.S. Dollars)	
600,000	101,351	NIBOR	5.75%	7.49%	(3,690)	2.8
500,000	89,710	NIBOR	4.00%	4.80%	(6,892)	1.8
800,000	143,536	NIBOR	4.75%	5.93%	(10,090)	3.8
1,000,000	162,200	NIBOR	4.25%	6.28%	2,794	4.8
					(17,878)	

Commodity Price Risk

We are exposed to changes in forecasted bunker fuel costs for certain vessels being time-chartered-out and for vessels servicing certain contracts of affreightment. We may use bunker fuel swap contracts as economic hedges to protect against changes in bunker fuel costs. As at March 31, 2014, we were not committed to any bunker fuel swap contracts.

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TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES

MARCH 31, 2014

PART II OTHER INFORMATION

Item 1 Legal Proceedings

See Item 1 Financial Statements: Note 10(a) Commitments and Contingencies.

Item 1A Risk Factors

In addition to the other information set forth in this Report on Form 6-K and the risk factors described below, you should carefully consider the risk factors discussed in Part I, Item 3. Key Information Risk Factors in our Annual Report on Form 20-F for the year ended December 31, 2013, which could materially affect our business, financial condition or results of operations.

Item 2 Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3 Defaults Upon Senior Securities

None

Item 4 Mine Safety Disclosures

None

Item 5 Other Information

None

Item 6 Exhibits

None

THIS REPORT ON FORM 6-K IS HEREBY INCORPORATED BY REFERENCE INTO THE FOLLOWING REGISTRATION STATEMENTS OF THE PARTNERSHIP:

REGISTRATION STATEMENT ON FORM S-8 (NO. 333-147682) FILED WITH THE SEC ON NOVEMBER 28, 2007

REGISTRATION STATEMENT ON FORM F-3 (NO. 333-175685) FILED WITH THE SEC ON JULY 21, 2011

**REGISTRATION STATEMENT ON FORM F-3 (NO. 333-178620) FILED WITH THE SEC ON
DECEMBER 19, 2011**

**REGISTRATION STATEMENT ON FORM F-3 (NO. 333-183225) FILED WITH THE SEC ON
AUGUST 10, 2012**

**REGISTRATION STATEMENT ON FORM F-3ASR (NO. 333-188051) FILED WITH THE SEC ON
APRIL 22, 2013**

**REGISTRATION STATEMENT ON FORM F-3 (NO. 333-188393) FILED WITH THE SEC ON
MAY 7, 2013**

**REGISTRATION STATEMENT ON FORM F-3 (NO. 333-188543) FILED WITH THE SEC ON
MAY 10, 2013**

**REGISTRATION STATEMENT ON FORM F-3 (NO. 333-193301) FILED WITH THE SEC ON
JANUARY 10, 2014**

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

TEEKAY OFFSHORE PARTNERS L.P.

By: Teekay Offshore GP L.L.C., its general partner

Date: May 19, 2014

By: /s/ Peter Evensen
Peter Evensen
Chief Executive Officer and Chief Financial Officer
(Principal Financial and Accounting Officer)

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