Teekay LNG Partners L.P.
Form 6-K
August 26, 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 June 30, 2014

Commission file number 1- 32479

TEEKAY LNG PARTNERS L.P.

(Exact name of Registrant as specified in its charter)

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 x 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 x

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 x

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TEEKAY LNG PARTNERS L.P. AND SUBSIDIARIES

REPORT ON FORM 6-K FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2014

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ITEM 1 FINANCIAL STATEMENTS

TEEKAY LNG PARTNERS L.P. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	$	$	$	$
VOYAGE REVENUES *(note 9a)*	101,323	96,619	202,813	193,726
OPERATING EXPENSES				
Voyage expenses	1,167	1,224	2,500	1,615
Vessel operating expenses *(note 9a)*	24,320	24,814	48,576	50,130
Depreciation and amortization	23,530	25,156	47,640	49,299
General and administrative *(note 9a)*	6,254	4,744	12,662	10,213
Total operating expenses	55,271	55,938	111,378	111,257
Income from vessel operations	46,052	40,681	91,435	82,469
OTHER ITEMS				
Equity income *(note 5)*	32,924	39,425	53,297	65,849
Interest expense *(note 7)*	(15,068)	(13,132)	(29,899)	(26,380)
Interest income	572	782	1,220	1,297
Realized and unrealized loss on derivative instruments *(note 10)*	(16,335)	10,666	(23,856)	2,381
Foreign currency exchange (loss) gain *(notes 7 and 10)*	(66)	(2,787)	(845)	5,424
Other income	208	407	426	876
	2,235	35,361	343	49,447
Net income before income tax expense	48,287	76,042	91,778	131,916
Income tax expense *(note 8)*	(375)	(800)	(770)	(1,643)
Net income	47,912	75,242	91,008	130,273
Other comprehensive loss:				
Unrealized loss on qualifying cash flow hedging instrument in equity accounted joint ventures before reclassifications, net of tax *(note 5c)*	(1,121)		(2,064)	
Realized loss on qualifying cash flow hedging instrument in equity accounted joint ventures reclassified to equity	391		782	

income, net of tax *(note 5c)*				
Other comprehensive loss attributable to General and limited partners	(730)		(1,282)	
Comprehensive income	47,182	75,242	89,726	130,273
Non-controlling interest in net and comprehensive income	4,263	5,581	9,113	6,167
General Partner s interest in net income	7,528	6,278	14,683	12,243
Limited partners interest in net income	36,121	63,383	67,212	111,863
Limited partners interest in net income per common unit:				
Basic	0.49	0.91	0.91	1.60
Diluted	0.49	0.91	0.91	1.60
Weighted-average number of common units outstanding:				
Basic	74,212,834	69,713,500	74,206,221	69,698,714
Diluted	74,255,543	69,732,097	74,252,842	69,709,382
Cash distributions declared per common unit	0.6918	0.6750	1.3836	1.3500

Related party transactions *(note 9)*

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

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TEEKAY LNG PARTNERS L.P. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED BALANCE SHEETS

(in thousands of U.S. Dollars)

	As at June 30, 2014 $	As at December 31, 2013 $
ASSETS		
Current		
Cash and cash equivalents	121,658	139,481
Accounts receivable, including non-trade of $14,529 (2013 $18,084) *(note 10)*	20,068	19,844
Prepaid expenses	6,219	5,756
Current portion of derivative assets *(note 10)*	17,500	18,444
Current portion of net investments in direct financing leases *(note 4)*	18,105	16,441
Advances to joint venture partner *(note 6a)*		14,364
Advances to affiliates *(notes 9b and 10)*	21,036	6,634
Total current assets	204,586	220,964
Restricted cash long-term *(note 4)*	498,400	497,298
Vessels and equipment		
At cost, less accumulated depreciation of $444,571 (2013 $413,074)	1,231,216	1,253,763
Vessels under capital leases, at cost, less accumulated depreciation of $159,701 (2013 $152,020)	530,195	571,692
Advances on newbuilding contracts *(notes 9e and 11a)*	117,778	97,207
Total vessels and equipment	1,879,189	1,922,662
Investment in and advances to equity accounted joint ventures *(notes 5, 6b and 9d)*	735,171	671,789
Net investments in direct financing leases *(note 4)*	676,476	683,254
Other assets	48,394	28,284
Derivative assets *(note 10)*	101,255	62,867
Intangible assets net	92,124	96,845
Goodwill liquefied gas segment	35,631	35,631
Total assets	4,271,226	4,219,594
LIABILITIES AND EQUITY		
Current		
Accounts payable	1,942	1,741
Accrued liabilities *(notes 10 and 14)*	46,876	45,796

Unearned revenue	14,295	14,342
Current portion of long-term debt *(note 7)*	161,596	97,114
Current obligations under capital lease *(note 4)*	65,716	31,668
Current portion of in-process contracts *(note 5a)*	6,234	1,113
Current portion of derivative liabilities *(note 10)*	86,626	76,980
Advances from affiliates *(note 9b)*	46,271	19,270
Total current liabilities	429,556	288,024
Long-term debt *(note 7)*	1,642,859	1,680,393
Long-term obligations under capital lease *(note 4)*	499,458	566,661
Long-term unearned revenue	34,929	36,689
Other long-term liabilities *(notes 4 and 5c)*	70,974	69,480
In-process contracts *(note 5a)*	28,147	3,660
Derivative liabilities *(note 10)*	169,867	130,903
Total liabilities	2,875,790	2,775,810
Commitments and contingencies *(notes 4, 5, 7, 10, and 11)*		
Equity		
Limited Partners	1,304,036	1,338,133
General Partner	52,103	52,526
Accumulated other comprehensive (loss) income	(1,151)	131
Partners equity	1,354,988	1,390,790
Non-controlling interest	40,448	52,994
Total equity	1,395,436	1,443,784
Total liabilities and total equity	4,271,226	4,219,594

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

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TEEKAY LNG PARTNERS L.P. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands of U.S. Dollars)

	Six Months Ended June 30, 2014 $	**Six Months Ended June 30, 2013 $**
Cash and cash equivalents provided by (used for)		
OPERATING ACTIVITIES		
Net income	91,008	130,273
Non-cash items:		
Unrealized loss (gain) on derivative instruments *(note 10)*	4,368	(21,426)
Depreciation and amortization	47,640	49,299
Unrealized foreign currency exchange (loss) gain *(notes 7 and 10)*	(66)	(5,993)
Equity income, net of dividends received of $2,600 (2013 nil)	(50,690)	(65,849)
Amortization of deferred debt issuance costs and other	742	1,494
Change in operating assets and liabilities	9,452	5,748
Expenditures for dry docking	(7,931)	(17,796)
Net operating cash flow	94,523	75,750
FINANCING ACTIVITIES		
Proceeds from issuance of long-term debt	209,215	219,748
Scheduled repayments of long-term debt	(48,320)	(42,999)
Prepayments of long-term debt	(130,000)	(10,000)
Scheduled repayments of capital lease obligations	(3,396)	(5,205)
Proceeds from units issued out of continuous offering program, net of offering costs		4,924
Advances to joint venture partners and equity accounted joint ventures *(note 6b)*		(16,785)
Increase in restricted cash	(1,197)	(952)
Cash distributions paid	(117,803)	(105,943)
Novation of derivative liabilities *(note 9f)*	2,985	
Dividends paid to non-controlling interest *(note 15b)*	(7,295)	(144)
Net financing cash flow	(95,811)	42,644
INVESTING ACTIVITIES		
Purchase of equity accounted investments *(notes 5 and 15c)*	(1)	(135,790)
Receipts from direct financing leases	5,114	3,233
Expenditures for vessels and equipment	(21,648)	(1,793)

Net investing cash flow	(16,535)	(134,350)
Decrease in cash and cash equivalents	(17,823)	(15,956)
Cash and cash equivalents, beginning of the period	139,481	113,577
Cash and cash equivalents, end of the period	121,658	97,621

Supplemental cash flow information *(note 15)*

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

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TEEKAY LNG PARTNERS L.P. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENT OF CHANGES IN TOTAL EQUITY

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

	TOTAL EQUITY					
	Partners Equity				Non-controlling Interest	Total
	Limited Partners		General Partner	Accumulated Other Comprehensive (Loss) Income (Note 5c)		
	Number of Common Units	$	$	$	$	$
Balance as at December 31, 2013	74,196	1,338,133	52,526	131	52,994	1,443,784
Net income		67,212	14,683		9,113	91,008
Other comprehensive loss				(1,282)		(1,282)
Cash distributions		(102,669)	(15,134)			(117,803)
Dividends paid to non-controlling interest					(21,659)	(21,659)
Equity based compensation *(note 13)*	17	1,360	28			1,388
Balance as at June 30, 2014	74,213	1,304,036	52,103	(1,151)	40,448	1,395,436

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

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TEEKAY LNG 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 or unless otherwise indicated)

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 LNG Partners L.P., which is a limited partnership formed under the laws of the Republic of The Marshall Islands, and its wholly owned or controlled subsidiaries (collectively, the *Partnership*). The preparation of consolidated 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 for the year ended December 31, 2013, filed with the SEC on April 29, 2014. In the opinion of management of Teekay GP L.L.C., the general partner of the Partnership (or the *General Partner*), these interim unaudited consolidated financial statements reflect all adjustments consisting solely 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. Significant intercompany balances and transactions have been eliminated upon consolidation. In addition, certain of the comparative figures have been reclassified to conform to the presentation adopted in the current period relating to in-process revenue contracts of $1.1 million and $3.7 million reclassified from unearned revenue and other long-term liabilities, respectively, to current portion of in-process contracts and in-process contracts, respectively, in the Partnership s consolidated balance sheets.

2. 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 2 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 a fair value on a recurring basis.

	June 30, 2014	December 31, 2013

	Fair Value Hierarchy Level	Carrying Amount Asset (Liability) $	Fair Value Asset (Liability) $	Carrying Amount Asset (Liability) $	Fair Value Asset (Liability) $
Recurring:					
Cash and cash equivalents and restricted cash	Level 1	620,058	620,058	636,779	636,779
Derivative instruments *(note 10)*					
Interest rate swap agreements assets	Level 2	121,520	121,520	81,119	81,119
Interest rate swap agreements liabilities	Level 2	(246,412)	(246,412)	(200,762)	(200,762)
Cross currency swap agreements	Level 2	(22,018)	(22,018)	(18,236)	(18,236)
Other derivative	Level 3	1,576	1,576	6,344	6,344
Other:					
Advances to equity accounted joint ventures *(note 6b)*	(i)	85,469	(i)	85,135	(i)
Advances to joint venture partner *(note 6a)*	(ii)			14,364	(ii)
Long-term receivable included in other assets	Level 2	16,452	16,452		
Long-term debt public *(note 7)*	Level 1	(260,880)	(275,881)	(263,534)	(274,240)
Long-term debt non-public *(note 7)*	Level 2	(1,543,575)	(1,473,247)	(1,513,973)	(1,409,252)

(i) The advances to equity accounted joint ventures together with the Partnership s equity investments in the joint ventures form the net aggregate carrying value of the Partnership s interests in the joint ventures in these consolidated financial statements. The fair values of the individual components of such aggregate interests are not determinable.

(ii) The Partnership owns a 99% interest in Teekay Tangguh Borrower LLC (or *Teekay Tangguh*), which owns a 70% interest in Teekay BLT Corporation (or the *Teekay Tangguh Joint Venture*), essentially giving the Partnership a 69% interest in the Teekay Tangguh Joint Venture. The advances from the Teekay Tangguh Joint Venture to the joint venture partner together with the joint venture partner s equity investment in the Teekay Tangguh Joint Venture form the net aggregate carrying value of the joint venture partner s interest in the Teekay Tangguh Joint Venture in these consolidated financial statements. The fair value of the individual components of such aggregate interest was not determinable as at December 31, 2013.

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TEEKAY LNG 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 or unless otherwise indicated)

Changes in fair value during the six months ended June 30, 2014 and 2013 for the Partnership s other derivative asset, the Toledo Spirit time-charter derivative, which is described below and is measured at fair value on a recurring basis using significant unobservable inputs (Level 3), are as follows:

	Six Months Ended June 30,	
	2014	**2013**
	$	**$**
Fair value at beginning of period	6,344	1,100
Realized and unrealized (losses) gains included in earnings	(3,224)	2,777
Settlements	(1,544)	23
Fair value at end of period	1,576	3,900

The Partnership s Suezmax tanker, the *Toledo Spirit*, operates pursuant to a time-charter contract that increases or decreases the otherwise fixed-hire rate established in the charter depending on the spot charter rates that the Partnership would have earned had it traded the vessel in the spot tanker market. The time-charter contract ends in August 2025, although the charterer has the right to terminate the time-charter in July 2018. In order to reduce the variability of its revenue under the *Toledo Spirit* time-charter, the Partnership entered into an agreement with Teekay Corporation under which Teekay Corporation pays the Partnership any amounts payable to the charterer of the *Toledo Spirit* as a result of spot rates being below the fixed rate, and the Partnership pays Teekay Corporation any amounts payable to the Partnership by the charterer of the *Toledo Spirit* as a result of spot rates being in excess of the fixed rate. The estimated fair value of this other derivative is based in part upon the Partnership s projection of future spot market tanker rates, which has been derived from current spot market tanker rates and long-term historical average rates as well as an estimated discount rate. The estimated fair value of this other derivative as of June 30, 2014 is based upon an average daily tanker rate of $23,788 (June 30, 2013 $22,241) over the remaining duration of the charter contract and a discount rate of 8.4% (June 30, 2013 8.8%). In developing and evaluating this estimate, the Partnership considers the current tanker market fundamentals as well as the short and long-term outlook. A higher or lower average daily tanker rate would result in a higher or lower fair value liability or a lower or higher fair value asset. A higher or lower discount rate would result in a lower or higher fair value asset or liability.

b) Financing Receivables

The following table contains a summary of the Partnership s loan receivables and other 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.

Class of Financing Receivable	Credit Quality Indicator	Grade	June 30, 2014 $	December 31, 2013 $
Direct financing leases	Payment activity	Performing	694,581	699,695
Other receivables:				
Long-term receivable and accrued revenue included in other assets	Payment activity	Performing	28,597	8,095
Advances to equity accounted joint ventures *(note 6b)*	Other internal metrics	Performing	85,469	85,135
Advances to joint venture partner *(note 6a)*	Other internal metrics	Settled		14,364
			808,647	807,289

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TEEKAY LNG 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 or unless otherwise indicated)

3. Segment Reporting

The following table includes results for the Partnership s segments for the periods presented in these financial statements.

	Three Months Ended June 30,					
	2014			2013		
	Liquefied Gas Segment $	Conventional Tanker Segment $	Total $	Liquefied Gas Segment $	Conventional Tanker Segment $	Total $
Voyage revenues	77,602	23,721	101,323	68,270	28,349	96,619
Voyage expenses	705	462	1,167	407	817	1,224
Vessel operating expenses	14,746	9,574	24,320	13,683	11,131	24,814
Depreciation and amortization	17,888	5,642	23,530	18,329	6,827	25,156
General and administrative (i)	4,460	1,794	6,254	3,233	1,511	4,744
Income from vessel operations	39,803	6,249	46,052	32,618	8,063	40,681

	Six Months Ended June 30,					
	2014			2013		
	Liquefied Gas Segment $	Conventional Tanker Segment $	Total $	Liquefied Gas Segment $	Conventional Tanker Segment $	Total $
Voyage revenues	152,566	50,247	202,813	136,300	57,426	193,726
Voyage expenses	1,528	972	2,500	407	1,208	1,615
Vessel operating expenses	29,460	19,116	48,576	27,676	22,454	50,130
Depreciation and amortization	36,001	11,639	47,640	35,619	13,680	49,299
General and administrative (i)	9,208	3,454	12,662	6,917	3,296	10,213
	76,369	15,066	91,435	65,681	16,788	82,469

Income from vessel operations

(i) Includes direct general and administrative expenses and indirect general and administrative expenses (allocated to each segment based on estimated use of corporate resources).

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

	June 30, 2014	**December 31, 2013**
	$	**$**
Total assets of the liquefied gas segment	3,683,649	3,591,693
Total assets of the conventional tanker segment	418,596	456,186
Unallocated:		
Cash and cash equivalents	121,658	139,481
Accounts receivable and prepaid expenses	26,287	25,600
Advances to affiliates	21,036	6,634
Consolidated total assets	4,271,226	4,219,594

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TEEKAY LNG 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 or unless otherwise indicated)

4. Vessel Charters

The minimum estimated charter hire payments for the remainder of the year and the next four fiscal years, as at June 30, 2014, for the Partnership s vessels chartered-in and vessels chartered-out are as follows:

Vessel Charters(i)	Remainder of 2014 $	2015 $	2016 $	2017 $	2018 $
Charters-in capital leases(ii)(iii)(iv)(v)	42,395	31,790	31,672	54,953	51,296
Charters-out operating leases(vi)	164,366	319,745	337,841	355,519	314,918
Charters-out direct financing leases(vii)	34,718	74,908	75,064	204,109	173,701
	199,084	394,653	412,905	559,628	488,619

(i) The Teekay Tangguh Joint Venture is a party to operating leases whereby it is leasing the *Tangguh Hiri* and the *Tangguh Sago* liquefied natural gas (or *LNG*) carriers (or the *Tangguh LNG Carriers*) to a third party, which is in turn leasing the vessels back to the joint venture. The table does not include the Partnership s minimum charter hire payments to be paid and received under these leases, which are described in more detail in Note 4 to the Partnership s audited consolidated financial statements filed with its Annual Report on Form 20-F for the year ended December 31, 2013.

(ii) As at June 30, 2014 and December 31, 2013, the Partnership had $475.8 million and $475.6 million, respectively, of cash which, including any interest earned on such amounts, is restricted to being used for charter hire payments of certain vessels chartered-in under capital leases. The Partnership also maintains restricted cash deposits relating to certain loans and to amounts received from charterers to be used only for dry-docking expenditures and emergency repairs, such cash totaled $22.6 million and $21.7 million as at June 30, 2014 and December 31, 2013, respectively.

(iii) As described in Note 4 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 Partnership has leasing arrangements relating to five of its LNG carriers (three through Teekay Nakilat Corporation (or the *RasGas II LNG Carriers*) and two through the Teekay Tangguh Joint Venture, in which the Partnership owns 70% and 69%

ownership interests, respectively). Under these arrangements, the Partnership is the lessee and the lessors claim tax depreciation on the capital expenditures they incurred to acquire these vessels. As is typical in these leasing arrangements, tax and change of law risks are assumed by the lessee. Lease payments under the lease arrangements are based on certain tax and financial assumptions at the commencement of the leases. If an assumption proves to be incorrect, the lessor is entitled to increase the lease payments to maintain its agreed after-tax margin.

The carrying amount of tax indemnification guarantees of the Partnership relating to these leasing arrangements as at June 30, 2014 was $23.4 million (December 31, 2013 $23.9 million) and is included as part of other long-term liabilities in the Partnership s consolidated balance sheets. The tax indemnification is for the duration of the lease contracts with the third parties plus the years it would take for the lease payments to be statute barred, and ends in 2033 for two vessels and 2041 for three vessels. Although there is no maximum potential amount of future payments, Teekay Nakilat Corporation and the Teekay Tangguh Joint Venture may terminate the lease arrangements on a voluntary basis at any time. If the lease arrangements terminate, Teekay Nakilat Corporation and the Teekay Tangguh Joint Venture will be required to pay termination sums to the lessor sufficient to repay the lessor s investment in the vessels and to compensate it for the tax effect of the terminations, including recapture of any tax depreciation.

(iv) Excludes estimated charter hire payments of $833.1 million for the period from 2019 to 2037.

(v) As at June 30, 2014, the Partnership was a party to capital leases on three Suezmax tankers. Under these capital leases, the owner has the option to require the Partnership to purchase the three vessels. The charterer, who is also the owner, also has the option to cancel the charter contracts. The amounts in the table assume the owner will not exercise its options to require the Partnership to purchase any of the three vessels from the owner, but rather it assumes the owner will cancel the charter contracts when the cancellation right is first exercisable, which is the 13th year anniversary of each respective contract. For one of the three Suezmax tankers, the *Huelva Spirit*, the cancellation option was first exercisable in April 2014. The owner reached an agreement to sell the *Huelva Spirit* to a third party and the vessel was sold on August 15, 2014. Upon sale of the *Huelva Spirit*, the Partnership was not required to pay the balance of the capital lease obligation of $26.8 million as at June 30, 2014, as the vessel under capital lease was returned to the owner and the capital lease obligation was concurrently extinguished.

(vi) Minimum scheduled future operating lease revenues do not include revenue generated from new contracts entered into after June 30, 2014, revenue from unexercised option periods of contracts that existed on June 30, 2014, or variable or contingent revenues. Therefore, the minimum scheduled future operating lease revenues should not be construed to reflect total charter hire revenues that may be recognized for any of the years.

(vii) As described in Note 4 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 Tangguh LNG Carriers time-charters are accounted for as direct financing leases. In addition, in September 2013 and November 2013, the Partnership acquired two 155,900-cubic meter LNG carriers (or the *Awilco LNG Carriers*) from Norway-based Awilco LNG ASA (or *Awilco*) and chartered them back to Awilco on five- and four-year fixed-rate bareboat charter contracts (each with a one-year extension option), respectively, with Awilco holding a fixed-price purchase obligation at the end of the charters. The bareboat charters with Awilco are accounted for as direct financing leases.

TEEKAY LNG 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 or unless otherwise indicated)

5. Equity Method Investments

a) On June 27, 2014, the Partnership acquired from BG International Limited (or *BG*) its ownership interests in four 174,000-cubic meter Tri-Fuel Diesel Electric LNG carrier newbuildings, which will be constructed by Hudong-Zhonghua Shipbuilding (Group) Co., Ltd. in China for a total fully built-up cost to the joint venture of approximately $1.0 billion. The vessels upon delivery, which are scheduled between September 2017 and January 2019, will each operate under 20-year fixed-rate time-charter contracts, plus extension options with Methane Services Limited, a wholly-owned subsidiary of BG. As compensation for BG s ownership interest in these four LNG carrier newbuildings, the Partnership assumed BG s obligation to provide the shipbuilding supervision and crew training services for the four LNG carrier newbuildings up to their delivery date pursuant to a ship construction support agreement. The Partnership estimates it will incur approximately $36.7 million of costs to provide these services, of which BG has agreed to pay a fixed amount of $20.3 million. On June 27, 2014, the Partnership estimated that the fair value of the service obligation was $30.2 million and the fair value of the amount due from BG was $16.5 million. The $30.2 million service obligation is included in the current portion of in-process contracts, and the in-process contracts and the receivable from BG is included in other assets in the Partnership s consolidated balance sheet. Through this transaction, the Partnership has a 30% ownership interest in two LNG carrier newbuildings and a 20% ownership interest in the remaining two LNG carrier newbuildings (collectively the *BG Joint Venture*). The excess of the Partnership s investment in the BG Joint Venture over the Partnership s share of the underlying carrying value of net assets acquired was approximately $13.7 million. This basis difference has notionally been allocated to the ship construction support agreements and the time-charter contracts. The Partnership accounts for its investment in the BG Joint Venture using the equity method.

b) In February 2013, the Partnership entered into a 50/50 joint venture agreement with Belgium-based Exmar NV (or *Exmar*) to own and charter-in liquefied petroleum gas (or *LPG*) carriers with a primary focus on the mid-size gas carrier segment. The joint venture entity, called Exmar LPG BVBA, took economic effect as of November 1, 2012 and, as of June 30, 2014, included 21 owned LPG carriers (including 10 newbuilding carriers scheduled for delivery between late-2014 and 2018) and four chartered-in LPG carriers. For its 50% ownership interest in the joint venture, including newbuilding payments made prior to the November 1, 2012 economic effective date of the joint venture, the Partnership invested $133.1 million in exchange for equity and a shareholder loan and assumed approximately $108 million of its pro rata share of existing debt and lease obligations as of the economic effective date. These debt and lease obligations are secured by certain vessels in the Exmar LPG BVBA fleet. The Partnership also paid a $2.7 million acquisition fee to Teekay Corporation that was recorded as part of the investment in Exmar LPG BVBA (see Note 9d). The excess of the book value of net assets acquired over Teekay LNG s investment in Exmar LPG BVBA, which amounted to approximately $6.0 million, has been accounted for as an adjustment to the value of the vessels, charter agreements and lease obligations of Exmar LPG BVBA and recognition of goodwill, in accordance with the finalized purchase price allocation. Control of Exmar LPG BVBA is shared equally between Exmar and the Partnership. The Partnership accounts for its investment in Exmar LPG BVBA using the equity method.

c) From June to July 2013, the joint venture between the Partnership and Marubeni Corporation (or the *Teekay LNG-Marubeni Joint Venture*) completed the refinancing of its short-term loan facilities by entering into separate

long-term debt facilities totaling approximately $963 million. These debt facilities mature between 2017 and 2030. The Partnership agreed to guarantee its 52% share of the secured loan facilities of the Teekay LNG-Marubeni Joint Venture and, as a result, recorded a guarantee liability of $0.7 million. The carrying value of the guarantee liability as at June 30, 2014, was $0.5 million (December 31, 2013 $0.6 million) and is included as part of other long-term liabilities in the Partnership s consolidated balance sheets. In addition, the Teekay LNG-Marubeni Joint Venture entered into an eight-year interest rate swap with a notional amount of $160.0 million, amortizing quarterly over the term of the interest rate swap to $70.4 million at maturity. The interest rate swap exchanges the receipt of LIBOR-based interest for the payment of a fixed rate of interest of 2.20% in the first two years and 2.36% in the last six years. This interest rate swap has been designated as a qualifying cash flow hedging instrument for accounting purposes. The Teekay LNG-Marubeni Joint Venture uses the same accounting policy for qualifying cash flow hedging instruments as the Partnership uses. The Partnership accounts for its investment in the Teekay LNG-Marubeni Joint Venture using the equity method.

6. Advances to Joint Venture Partner and Equity Accounted Joint Ventures

a) The Partnership owns a 69% interest in the Teekay Tangguh Joint Venture. As of December 31, 2013, the Teekay Tangguh Joint Venture had non-interest bearing advances of $10.2 million to the Partnership s joint venture partner, BLT LNG Tangguh Corporation, and advances of $4.2 million to its parent company, P.T. Berlian Laju Tanker. The advances to P.T. Berlian Laju Tanker were due on demand and bore interest at a fixed-rate of 8.0%. These advances by the Teekay Tangguh Joint Venture were made between 2010 and 2012 as advances on dividends. On February 1, 2014, the Teekay Tangguh Joint Venture declared dividends of $69.5 million of which $14.4 million was used to settle the advances made to BLT LNG Tangguh Corporation and P.T. Berlian Laju Tanker.

b) The Partnership has a 50% interest in Exmar LPG BVBA and a 50% interest in another joint venture with Exmar (or the *Excalibur Joint Venture*), which owns an LNG carrier, the *Excalibur*. As of June 30, 2014, the Partnership had advances of $81.7 million due from Exmar LPG BVBA, of which $67.9 million was assumed through the acquisition of Exmar LPG BVBA, and $3.0 million is due from the Excalibur Joint Venture. These advances bear interest at LIBOR plus margins ranging from 0.50% to 2.0% and have no fixed repayment terms. As at June 30, 2014, the interest accrued on these advances was $0.8 million (December 31, 2013 $0.4 million).

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7. Long-Term Debt

	June 30, 2014 $	December 31, 2013 $
U.S. Dollar-denominated Revolving Credit Facilities due through 2018	175,000	235,000
U.S. Dollar-denominated Term Loan due through 2018	98,472	103,207
U.S. Dollar-denominated Term Loan due through 2018	120,833	125,000
U.S. Dollar-denominated Term Loan due through 2018	130,000	
U.S. Dollar-denominated Term Loan due through 2019	284,477	296,935
U.S. Dollar-denominated Term Loan due through 2021	291,650	297,956
U.S. Dollar-denominated Term Loan due through 2021	99,015	102,372
U.S. Dollar-denominated Unsecured Demand Loan	13,282	13,282
Norwegian Kroner-denominated Bond due in 2017	114,135	115,296
Norwegian Kroner-denominated Bond due in 2018	146,745	148,238
Euro-denominated Term Loans due through 2023	330,846	340,221
Total	1,804,455	1,777,507
Less current portion	161,596	97,114
Total	1,642,859	1,680,393

As at June 30, 2014, the Partnership had three long-term revolving credit facilities available, which, as at such date, provided for borrowings of up to $410.6 million, of which $235.6 million was undrawn. Interest payments are based on LIBOR plus margins. The amount available under the revolving credit facilities reduces by $17.3 million (remainder of 2014), $84.1 million (2015), $27.3 million (2016), $28.2 million (2017) and $253.7 million (2018). All the revolving credit facilities may be used by the Partnership to fund general partnership purposes and to fund cash distributions. The Partnership is required to repay all borrowings used to fund cash distributions within 12 months of their being drawn, from a source other than further borrowings. The revolving credit facilities are collateralized by first-priority mortgages granted on seven of the Partnership s vessels, together with other related security, and include a guarantee from the Partnership or its subsidiaries of all outstanding amounts.

At June 30, 2014, the Partnership had a U.S. Dollar-denominated term loan outstanding in the amount of $98.5 million. Interest payments on this loan are based on LIBOR plus 2.75% and require quarterly interest and principal payments and a bullet repayment of $50.7 million due at maturity in 2018. This loan facility is collateralized by a first-priority mortgage on the five vessels to which the loan relates, together with certain other related security,

and is guaranteed by the Partnership.

At June 30, 2014, the Partnership had a U.S. Dollar-denominated term loan outstanding in the amount of $120.8 million. Interest payments on this loan are based on LIBOR plus 2.80% and require quarterly interest and principal payments and a bullet repayment of $83.3 million due at maturity in 2018. This loan facility is collateralized by a first-priority mortgage on one vessel to which the loan relates, together with certain other related security, and is guaranteed by the Partnership.

At June 30, 2014, the Partnership had a U.S. Dollar-denominated term loan outstanding in the amount of $130.0 million. Interest payments on this loan are based on LIBOR plus 2.75% and require quarterly interest and principal payments and a bullet repayment of $95.3 million due at maturity in 2018. This loan facility is collateralized by a first-priority mortgage on one vessel to which the loan relates, together with certain other related security, and is guaranteed by the Partnership.

The Partnership owns a 70% interest in Teekay Nakilat Corporation (or the *Teekay Nakilat Joint Venture*), a consolidated entity of the Partnership. The Teekay Nakilat Joint Venture has a U.S. Dollar-denominated term loan outstanding, which, as at June 30, 2014, totaled $284.5 million, of which $116.3 million bears interest at a fixed-rate of 5.39% and requires quarterly interest and principal payments over the remaining term of the loan maturing in 2018 and 2019. The remaining $168.2 million bears interest based on LIBOR plus 0.68%, which requires quarterly interest payments over the remaining term of the loan and will require bullet repayments of approximately $56.0 million for each of the three vessels due at maturity in 2018 and 2019. The term loan is collateralized by first-priority mortgages on the three vessels to which the loan relates, together with certain other related security and certain guarantees from the Partnership.

The Partnership owns a 69% interest in the Teekay Tangguh Joint Venture, a consolidated entity of the Partnership. The Teekay Tangguh Joint Venture has a U.S. Dollar-denominated term loan outstanding, which, as at June 30, 2014, totaled $291.6 million. Interest payments on the loan are based on LIBOR plus margins. Interest payments on one tranche under the loan facility are based on LIBOR plus 0.30%, while interest payments on the second tranche are based on LIBOR plus 0.63%. One tranche reduces in quarterly payments while the other tranche correspondingly is drawn up with a final $95.0 million bullet payment for each of two vessels due in 2021. This loan facility is collateralized by first-priority mortgages on the two vessels to which the loan relates, together with certain other security and is guaranteed by the Partnership.

At June 30, 2014, the Partnership had a U.S. Dollar-denominated term loan outstanding in the amount of $99.0 million. Interest payments on one tranche under the loan facility are based on LIBOR plus 0.30%, while interest payments on the second tranche are based on LIBOR plus 0.70%. One tranche reduces in semi-annual payments while the other tranche correspondingly is drawn up every six months with a final $20.0 million bullet payment for each of two vessels due at maturity in 2021. This loan facility is collateralized by first-priority mortgages on the two vessels to which the loan relates, together with certain other related security and is guaranteed by Teekay Corporation.

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The Teekay Nakilat Joint Venture has a U.S. Dollar-denominated demand loan outstanding owing to Qatar Gas Transport Company Ltd. (Nakilat), which, as at June 30, 2014, totaled $13.3 million. Interest payments on this loan are based on a fixed interest rate of 4.84%. The loan is repayable on demand.

The Partnership has Norwegian Kroner (or *NOK*) 700 million of senior unsecured bonds that mature in May 2017 in the Norwegian bond market. As at June 30, 2014, the carrying amount of the bonds was $114.1 million and the bonds are listed on the Oslo Stock Exchange. The interest payments on the bonds are based on NIBOR plus a margin of 5.25%. The Partnership has a cross currency swap, to swap all interest and principal payments into U.S. Dollars, with the interest payments fixed at a rate of 6.88% (see Note 10) and the transfer of principal fixed at $125.0 million upon maturity in exchange for NOK 700 million.

The Partnership has NOK 900 million of senior unsecured bonds that mature in September 2018 in the Norwegian bond market. As at June 30, 2014, the carrying amount of the bonds was $146.7 million and the bonds are listed on the Oslo Stock Exchange. The interest payments on the bonds are based on NIBOR plus a margin of 4.35%. The Partnership has a cross currency swap, to swap all interest and principal payments into U.S. Dollars, with the interest payments fixed at a rate of 6.43% (see Note 10) and the transfer of principal fixed at $150.0 million upon maturity in exchange for NOK 900 million.

The Partnership has two Euro-denominated term loans outstanding, which as at June 30, 2014, totaled 241.7 million Euros ($330.8 million). Interest payments are based on EURIBOR plus margins, which ranged from 0.60% to 2.25% as of June 30, 2014, and the loans require monthly interest and principal payments. The term loans have varying maturities through 2023. The term loans are collateralized by first-priority mortgages on two vessels to which the loans relate, together with certain other related security and are guaranteed by the Partnership and one of its subsidiaries.

The weighted-average effective interest rate for the Partnership s long-term debt outstanding at June 30, 2014 and December 31, 2013 was 2.52% and 2.48%, respectively. This rate does not reflect the effect of related interest rate swaps that the Partnership has used to economically hedge certain of its floating-rate debt (see Note 10). At June 30, 2014, the margins on the Partnership s outstanding revolving credit facilities and term loans ranged from 0.30% to 2.80%.

All Euro-denominated term loans and NOK-denominated bonds are revalued at the end of each period using the then-prevailing U.S. Dollar exchange rate. Due primarily to the revaluation of the Partnership s NOK-denominated bonds, the Partnership s Euro-denominated term loans, capital leases and restricted cash, and the change in the valuation of the Partnership s cross currency swap, the Partnership incurred foreign exchange (losses) gains of ($0.1) million and ($2.8) million, and ($0.8) million and $5.4 million, of which these amounts were primarily unrealized, for the three months ended June 30, 2014 and 2013, and the six months ended June 30, 2014 and 2013, respectively.

The aggregate annual long-term debt principal repayments required subsequent to June 30, 2014 are $53.1 million (remainder of 2014), $162.5 million (2015), $109.4 million (2016), $225.6 million (2017), $799.9 million (2018) and $454.0 million (thereafter).

The Partnership and a subsidiary of Teekay Corporation are borrowers under a loan arrangement and are joint and severally liable for the obligations to the lender. 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 among the co-obligor, and any additional amount the Partnership expects to pay on behalf of the co-obligor. This loan arrangement matures in 2021 and as of June 30, 2014 had an outstanding balance of $195.2 million, of which $99.0 million was the Partnership s share. Teekay Corporation has indemnified the Partnership in respect of any losses and expenses arising from any breach by the co-obligor of the terms and conditions of the loan facility.

Certain loan agreements require that (a) the Partnership maintains minimum levels of tangible net worth and aggregate liquidity, (b) the Partnership maintains certain ratios of vessel values as it relates to the relevant outstanding loan principal balance, (c) the Partnership not exceed a maximum level of leverage, and (d) one of the Partnership s subsidiaries maintains restricted cash deposits. The Partnership s ship-owning subsidiaries may not, among other things, pay dividends or distributions if the Partnership is in default under its term loans or revolving credit facilities. One of the Partnership s term loans is guaranteed by Teekay Corporation and contains 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. As at June 30, 2014, the Partnership, and Teekay Corporation and their affiliates were in compliance with all covenants relating to the Partnership s credit facilities and term loans.

8. Income Tax

The components of the provision for income taxes were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	$	$	$	$
Current	(375)	(533)	(770)	(1,181)
Deferred		(267)		(462)
Income tax expense	(375)	(800)	(770)	(1,643)

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9. Related Party Transactions

a) Two of the Partnership s LNG carriers, the *Arctic Spirit* and *Polar Spirit*, are employed on long-term charter contracts with subsidiaries of Teekay Corporation. In addition, the Partnership and certain of its operating subsidiaries have entered into services agreements with certain subsidiaries of Teekay Corporation pursuant to which the Teekay Corporation subsidiaries provide the Partnership and its subsidiaries with administrative, commercial, crew training, advisory, business development, technical and strategic consulting services. Finally, the Partnership reimburses the General Partner for expenses incurred by the General Partner that are necessary for the conduct of the Partnership s business. Such related party transactions were as follows for the periods indicated:

	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
	$	$	$	$
Revenues[(i)]	9,452	9,398	18,801	16,505
Vessel operating expenses[(ii)]	3,245	2,587	6,074	4,938
General and administrative[(iii)]	4,065	2,816	7,134	6,004

(i) Commencing in 2008, the *Arctic Spirit* and *Polar Spirit* were time-chartered to Teekay Corporation at a fixed-rate for a period of ten years (plus options exercisable by Teekay Corporation to extend up to an additional 15 years).

(ii) Includes ship management and crew training services provided by Teekay Corporation.

(iii) Includes commercial, strategic, advisory, 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.

b) As at June 30, 2014 and December 31, 2013, non-interest bearing advances to affiliates totaled $21.0 million and $6.6 million, respectively, and non-interest bearing advances from affiliates totaled $46.3 million and $19.3 million, respectively. These advances are unsecured and have no fixed repayment terms.

c) The Partnership s Suezmax tanker the *Toledo Spirit* operates pursuant to a time-charter contract that increases or decreases the otherwise fixed-hire rate established in the charter depending on the spot charter rates that the Partnership would have earned had it traded the vessel in the spot tanker market. The time-charter contract ends in

August 2025, although the charterer has the right to terminate the time-charter in July 2018. The Partnership has entered into an agreement with Teekay Corporation under which Teekay Corporation pays the Partnership any amounts payable to the charterer as a result of spot rates being below the fixed rate, and the Partnership pays Teekay Corporation any amounts payable to the Partnership as a result of spot rates being in excess of the fixed rate. The amounts receivable or payable to Teekay Corporation are settled annually (see Notes 2 and 10).

d) In March 2013, the Partnership paid a $2.7 million fee to Teekay Corporation relating to services in support of the Partnership s successful acquisition of its 50% interest in Exmar LPG BVBA (see Note 5b). This acquisition fee is reflected as part of investments in and advances to equity accounted joint ventures in the Partnership s consolidated balance sheets.

e) The Partnership has services agreements with certain subsidiaries of Teekay Corporation pursuant to which the Teekay Corporation subsidiaries provide the Partnership with shipbuilding and site supervision services relating to the five LNG newbuildings the Partnership owns. These costs are capitalized and included as part of advances on newbuilding contracts in the Partnership s consolidated balance sheets. As at June 30, 2014 and December 31, 2013, shipbuilding and site supervision costs provided by Teekay Corporation subsidiaries totaled $0.8 million and $0.2 million, respectively.

f) In March 2014, two interest rate swap agreements were novated from Teekay Corporation to the Partnership. Teekay Corporation concurrently paid the Partnership $3.0 million in cash consideration, which represents the estimated fair value of the interest rate swap liabilities on the novation date.

g) As part of the Partnership s acquisition of its ownership interest in the BG Joint Venture (see Note 5a), the Partnership entered into an agreement with a subsidiary of Teekay Corporation whereby Teekay Corporation s subsidiary will, on behalf of the Partnership, provide shipbuilding supervision and crew training services for the four LNG carrier newbuildings in the BG Joint Venture up to their delivery date. All costs incurred by Teekay Corporation s subsidiary, plus a reasonable profit markup, will be charged to the Partnership. As of June 30, 2014, no costs have been charged to the Partnership.

10. Derivative Instruments

The Partnership uses derivative instruments in accordance with its overall risk management policy. The Partnership has not designated derivative instruments described within this note as hedges for accounting purposes.

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Foreign Exchange Risk

In May 2012 and September 2013, concurrently with the issuance of NOK 700 million and NOK 900 million, respectively, of senior unsecured bonds (see Note 7), the Partnership entered into cross currency swaps and pursuant to these swaps the Partnership receives the principal amount in NOK on maturity dates of the swaps in exchange for payments 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 of the Partnership s NOK-denominated bonds due in 2017 and 2018, and to economically hedge the interest rate exposure. The following table reflects information relating to the cross currency swaps as at June 30, 2014.

Principal Amount	Principal Amount	Floating Rate Receivable		Fixed Rate	Fair Value / Carrying Amount of (Liability)	Weighted-Average Remaining
		Reference				
NOK	$	Rate	Margin	Payable	$	Term (Years)
700,000	125,000	NIBOR	5.25%	6.88%	(14,513)	2.8
900,000	150,000	NIBOR	4.35%	6.43%	(7,505)	4.2
					(22,018)	

Interest Rate Risk

The Partnership enters into interest rate swaps which either exchange a receipt of floating interest for a payment of fixed interest or a payment of floating interest for a receipt of fixed interest to reduce the Partnership s exposure to interest rate variability on certain of its outstanding floating-rate debt and floating-rate restricted cash deposits. As at June 30, 2014, the Partnership was committed to the following interest rate swap agreements:

	Interest Rate Index	Principal Amount $	Fair Value / Carrying Amount of Assets (Liability)	Weighted-Average Remaining Term (years)	Fixed Interest Rate (%) [i]

			$		
LIBOR-Based Debt:					
U.S. Dollar-denominated interest rate swaps (ii)	LIBOR	400,757	(91,531)	22.6	4.9
U.S. Dollar-denominated interest rate swaps (ii)	LIBOR	192,924	(38,269)	4.7	6.2
U.S. Dollar-denominated interest rate swaps	LIBOR	90,000	(13,171)	4.2	4.9
U.S. Dollar-denominated interest rate swaps	LIBOR	100,000	(12,687)	2.5	5.3
U.S. Dollar-denominated interest rate swaps (iii)	LIBOR	187,500	(36,754)	14.5	5.2
U.S. Dollar-denominated interest rate swaps (iii)	LIBOR	80,335	(4,085)	7.1	2.8
U.S. Dollar-denominated interest rate swaps (iv)	LIBOR	320,000	(4,160)	1.8	2.9
U.S. Dollar-denominated interest rate swaps (ii)	LIBOR	130,000	(1,510)	4.5	1.7
LIBOR-Based Restricted Cash Deposit:					
U.S. Dollar-denominated interest rate swaps (ii)	LIBOR	469,066	121,309	22.6	4.8
EURIBOR-Based Debt:					
Euro-denominated interest rate swaps(v)	EURIBOR	330,845	(44,034)	6.5	3.1
			(124,892)		

(i) Excludes the margins the Partnership pays on its floating-rate term loans, which, at June 30, 2014, ranged from 0.30% to 2.80%.

(ii) Principal amount reduces quarterly.

(iii) Principal amount reduces semi-annually.

(iv) These interest rate swaps are being used to economically hedge expected interest payments on new debt that is planned to be outstanding from 2016 to 2021. These interest rate swaps are subject to mandatory early termination in 2016 whereby the swaps will be settled based on their fair value at that time.

(v) Principal amount reduces monthly to 70.1 million Euros ($96.0 million) by the maturity dates of the swap agreements.

As at June 30, 2014, the Partnership had multiple interest rate swaps and cross currency swaps with the same counterparty that are subject to the same master agreements. 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 June 30, 2014, these interest rate swaps and cross currency swaps had an aggregate fair value asset amount of $121.3 million and an aggregate fair value liability amount of $208.7 million.

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Credit Risk

The Partnership is 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, 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 practical, interest rate swaps are entered into with different counterparties to reduce concentration risk.

Other Derivative

In order to reduce the variability of its revenue, the Partnership has entered into an agreement with Teekay Corporation under which Teekay Corporation pays the Partnership any amounts payable to the charterer of the *Toledo Spirit* as a result of spot rates being below the fixed rate, and the Partnership pays Teekay Corporation any amounts payable to the Partnership by the charterer of the *Toledo Spirit* as a result of spot rates being in excess of the fixed rate. The fair value of the derivative asset at June 30, 2014 was $1.6 million (December 31, 2013 an asset of $6.3 million).

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

	Accounts receivable/ Advances to affiliates	Current portion of derivative assets	Derivative assets	Accrued liabilities	Current portion of derivative liabilities	Derivative liabilities
As at June 30, 2014						
Interest rate swap agreements	4,565	17,200	99,755	(11,812)	(85,007)	(149,593)
Cross currency swap agreements				(125)	(1,619)	(20,274)
Toledo Spirit time-charter derivative		300	1,500	(224)		
	4,565	17,500	101,255	(12,161)	(86,626)	(169,867)
As at December 31, 2013						
Interest rate swap agreements	4,608	17,044	59,467	(10,960)	(75,615)	(114,187)
Cross currency swap agreement				(155)	(1,365)	(16,716)
Toledo Spirit time-charter derivative	1,544	1,400	3,400			
	6,152	18,444	62,867	(11,115)	(76,980)	(130,903)

Realized and unrealized gains (losses) relating to interest rate swap agreements and the Toledo Spirit time-charter derivative are recognized in earnings and reported in realized and unrealized loss on derivative instruments in the Partnership s consolidated statements of income and comprehensive income. The effect of the gain (loss) on these derivatives on the Partnership s consolidated statements of income and comprehensive income is as follows:

	Three Months Ended June 30,					
	2014			2013		
	Realized gains (losses)	**Unrealized gains (losses)**	**Total**	**Realized gains (losses)**	**Unrealized gains (losses)**	**Total**
Interest rate swap agreements	(10,020)	(5,391)	(15,411)	(9,496)	19,885	10,389
Toledo Spirit time-charter derivative	(224)	(700)	(924)	(23)	300	277
	(10,244)	(6,091)	(16,335)	(9,519)	20,185	10,666

	Six Months Ended June 30,					
	2014			2013		
	Realized gains (losses)	**Unrealized gains (losses)**	**Total**	**Realized gains (losses)**	**Unrealized gains (losses)**	**Total**
Interest rate swap agreements	(19,264)	(1,368)	(20,632)	(19,022)	18,626	(396)
Toledo Spirit time-charter derivative	(224)	(3,000)	(3,224)	(23)	2,800	2,777
	(19,488)	(4,368)	(23,856)	(19,045)	21,426	2,381

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Unrealized and realized gains (losses) relating to cross currency swap agreements are recognized in earnings and reported in foreign currency exchange (loss) gain in the Partnership s consolidated statements of income and comprehensive income. For the three and six months ended June 30, 2014, unrealized losses relating to the cross currency swap agreements of $7.7 million and $3.8 million, respectively, and realized losses of $0.3 million and $0.6 million, respectively, were recognized in earnings. For the three and six months ended June 30, 2013, unrealized losses of $2.7 million and $8.9 million, respectively, and realized losses of $0.1 million and a nominal amount, respectively, were recognized in earnings.

11. Commitments and Contingencies

a) In December 2012, July 2013 and November 2013, the Partnership signed contracts with Daewoo Shipbuilding & Marine Engineering Co., Ltd., (or *DSME*) for the construction of five 173,400-cubic meter LNG carriers at a total cost of approximately $1,050 million. These newbuilding vessels will be equipped with the M-type, Electronically Controlled, Gas Injection (or *MEGI*) twin engines, which are expected to be significantly more fuel-efficient and have lower emission levels than other engines currently being utilized in LNG shipping. The two vessels ordered in December 2012 are scheduled for delivery in 2016 and, upon delivery of the vessels, will be chartered to Cheniere Marketing L.L.C. at fixed rates for a period of five years. The Partnership intends to secure charter contracts for the remaining three vessels prior to their delivery in 2017. As at June 30, 2014, costs incurred under these newbuilding contracts totaled $117.8 million and the estimated remaining costs to be incurred are $71.2 million (remainder of 2014), $137.7 million (2015), $296.9 million (2016) and $426.4 million (2017).

b) As described in Note 4, the Teekay Nakilat Joint Venture is the lessee under 30-year capital lease arrangements with a third party for the three RasGas II LNG Carriers (or the *RasGas II Leases*). The UK taxing authority (or *HMRC*) has been urging the lessor as well as other lessors under capital lease arrangements that have tax benefits similar to the ones provided by the RasGas II Leases, to terminate such finance lease arrangements and has in other circumstances challenged the use of similar structures. As a result, the lessor has requested that the Teekay Nakilat Joint Venture contemplate the termination of the RasGas II Leases or entertain other alternatives for the leasing structure. The Teekay Nakilat Joint Venture has declined the request from HMRC to voluntarily terminate the RasGas II Leases primarily because of a January 2012 court decision from the First Tribunal regarding a similar financial lease of an LNG carrier that ruled in favor of the taxpayer, as well as a 2013 decision from the Upper Tribunal that upheld the 2012 verdict. However, HMRC appealed the 2013 decision to the Court of Appeal and in August 2014, HMRC was successful in having the judgment of the First Tribunal (in favor of the taxpayer) set aside. The matter will now be reconsidered by the First Tribunal, taking into account the appellate court s comments on their earlier judgment.

If HMRC is able to successfully challenge the RasGas II Leases, the Teekay Nakilat Joint Venture could be subject to significant costs associated with the termination of the lease or increased lease payments to compensate the lessor for the lost tax benefits. The Partnership estimates its 70.0% share of the potential exposure to be approximately

$34 million, exclusive of any interest rate swap termination costs and costs associated with any new financing.

c) As described in Note 5a, the Partnership has an ownership interest in the BG Joint Venture and as part of the acquisition, agreed to assume BG s obligation to provide shipbuilding supervision and crew training services for the four LNG carrier newbuildings up to their delivery dates pursuant to a ship construction support agreement. The shipbuilding and crew training obligation to be incurred, net of the reimbursement from BG are $2.5 million (remainder of 2014), $3.7 million (2015), $2.0 million (2016), $2.4 million (2017), $3.0 million (2018) and $2.8 million (thereafter).

In addition, the BG Joint Venture secured a $787.0 million debt facility to finance a portion of the estimated fully built-up cost of $1.0 billion for its four newbuilding carriers with the remaining portion to be financed pro-rata based on ownership interests by the Partnership and the other partners. The Partnership s proportionate share of the newbuilding installments, net of the financing, are $3.8 million (remainder of 2014), $4.9 million (2015), $7.9 million (2016), $15.0 million (2017), $17.3 million (2018) and $6.3 million (thereafter).

12. Total Capital and Net Income Per Unit

At June 30, 2014, approximately 66.0% 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.

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 $100.0 million. The Partnership did not sell any units under the COP during the three and six months ended June 30, 2014. During the three and six months ended June 30, 2013, the Partnership sold 124,071 common units under the COP for net proceeds of $4.9 million.

Net Income Per Unit

Net income per common unit is determined by dividing net income, after deducting the non-controlling interest and the General Partner s interest, by the weighted-average number of units outstanding during the period. 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 loss 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 after establishment of cash reserves determined 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 expenditures and anticipated credit needs. In addition, the General Partner is entitled to incentive distributions if the amount the Partnership distributes to unitholders with respect to any quarter exceeds specified target levels. Unlike available cash, net income is affected by non-cash items, such as depreciation and amortization, unrealized gains or losses on non-designated derivative instruments and foreign currency translation gains or losses.

TEEKAY LNG PARTNERS L.P. AND SUBSIDIARIES

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During the three and six months ended June 30, 2014 and 2013, cash distributions exceeded $0.4625 per unit and, consequently, the assumed distribution 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 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.

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

13. Unit-Based Compensation

In March 2014, a total of 9,521 common units, with an aggregate value of $0.4 million, were granted 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 under the Teekay LNG Partners L.P. 2005 Long-Term Incentive Plan to certain of the Partnership s employees and to certain employees of Teekay Corporation s subsidiaries that provide services to the Partnership. The Partnership measures the cost of such awards using the grant date fair value of the award and recognizes that cost, net of estimated forfeitures, over the requisite service period. The requisite service period consists of the period from the grant date of the award to the earlier of the date of vesting or the date the recipient becomes eligible for retirement. For unit-based compensation awards subject to graded vesting, the Partnership calculates the value for the award as if it was one single award with one expected life and amortizes the calculated expense for the entire award on a straight-line basis over the requisite service period. The compensation cost of the Partnership s unit-based compensation awards are reflected in general and administrative expenses in the Partnership s consolidated statements of income and comprehensive in