



TEEKAY TANKERS LTD.'S FIRST QUARTER AND 2019 EARNINGS RESULTS CONFERENCE CALL

Company: Teekay Tankers Ltd.

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Conference Time: 13:00 ET

Operator: Welcome to Teekay Tankers Ltd.'s First Quarter 2019 Earnings Results Conference Call.

During the call, all participants will be in a listen-only mode. Afterwards, you will be invited to participate in a question and answer session. At that time, if you have a question, participants will be asked to press star one to register for a question. For assistance during the call, please press star zero on your touchtone phone. As a reminder, this call is being recorded.

Now for opening remarks and introductions, I'd like to turn the call over to Mr. Kevin Mackay, Teekay Tankers, Chief Executive Officer. Please go ahead sir.

Lee Davidson: Before Kevin begins, I'd like to direct all participants to our website, www.teekaytankers.com, where you'll find a copy of our first quarter 2019 earnings presentation. Kevin will review this presentation during today's conference call.

Please allow me to remind you that our discussion today contains forward-looking statements. Actual results may differ materially from results projected by those forward-looking statements. Additional information concerning factors that could cause actual results to materially differ from those in the forward-looking statements is contained in the first quarter 2019 earnings release and earnings presentation available on our website.

I'll now turn the call over to Kevin to begin.



Kevin Mackay: Thank you, Lee. Hello everyone and thank you very much for joining us today for Teekay Tankers First Quarter 2019 Earnings Conference Call. With me here in Vancouver, I have Stewart Andrade, Teekay Tanker's CFO; and Christian Waldegrave, Director of Research at Teekay Tankers.

Beginning with our recent highlights from slide three of the presentation, Teekay Tankers generated total adjusted EBITDA of \$63.4 million during the first quarter, comparable to the \$63 million in the previous quarter. We reported adjusted net income of \$14.6 million, or \$0.05 per share in the first quarter, in line with the previous quarter.

These strong results were driven by moderately increased crude tanker spot rates during the first quarter of 2019. However, spot tanker rates have declined since the latter half of the quarter as the market has faced a number of seasonal and other short-term headwinds. We believe these headwinds are temporary in nature, and expect a significant firming in the tanker market from the second half of 2019 and into 2020. I will cover our market outlook in more detail later in the presentation.

In May, we completed the previously announced sale-leaseback transaction relating to two Suezmax tankers, and also increased the amount of bailable under the loan to finance the company's RSA pool management operations, which, together, increased liquidity by approximately \$40 million. Having completed these financial initiatives, we have a strong liquidity position which currently stands at approximately \$160 million, and have no plans for further financing initiatives to increase liquidity.

Lastly, we continue to position Teekay Tankers to best capture value and maximize cash flow from the current and forward spot tanker market. Recently, we chartered out a Suezmax vessel for six months at \$27,500 a day to protect against near-term weakness in this vessel class. We also in-chartered an Aframax vessel for delivery later in the year to capture additional upside from what we believe will be a much stronger market later this year and next. The vessel was taken for a firm two-year period at \$21,000 per day with an option to extend for a further one year.



Turning to slide four, we look at recent developments in the tanker spot market. Tanker spot rates have shown resilience in the face of near-term headwinds at the start of 2019, with the company registering its highest first quarter earnings since 2016. Rates during the first quarter were supported by the same positive drivers that we saw in the fourth quarter of last year; namely high seasonal oil demand, the impact of winter weather delays, and relatively high global oil production prior to the full implementation of OPEC supply cuts.

Spot rates have subsequently fallen during the second quarter, which is typical at this time of the year due to seasonally lower demand. However, the market also faces some near-term challenges in the form of OPEC supply cuts; heavier than normal refinery maintenance as refiners prepare for IMO 2020; and relatively high fleet growth at the start of the year.

This has led to a decline in rates during Q2 as shown by the chart on the right, although, our spot earnings to date are significantly higher year-on-year, which demonstrates that the market is fundamentally better balanced than it was 12 months ago. Furthermore, we believe that the headwinds that we are currently facing are temporary in nature, and we anticipate that the market will firm significantly in the second half of this year.

Turning to slide five, we look at positive developments in the demand side that will continue to drive the tanker market recovery in the coming months. Global oil demand remains relatively firm with a forecast of 1.3 million barrels per day growth in 2019 and 1.5 million barrels per day growth in 2020. This is in line with long-term averages and shows that demand for oil remains robust in spite of uncertainties in the global economy.

More importantly for tanker demand, global refinery throughput is set to increase significantly in the coming months, as shown by the chart on the top right of the slide. This is partly due to normal seasonality, but also reflects the fact that refiners will have to increase throughput in order to produce

sufficient low sulfur fuel ahead of the new IMO regulations that come into force from January of next year.

The new IMO regulations could also provide to boost to tanker demand in the form of new trading patterns for both crude and products, as well as floating storage demand. In total, the IEA forecasts the 4.6 million barrel per day increase in global refinery throughput between the seasonal low point in March and seasonal peak in August. This should generate significant demand for both crude and products tankers in the coming months.

Tanker demand should be further boosted by an increase in US crude oil exports later in the year as new pipeline capacity comes online, linking the Permian Basin to the US Gulf Coast. It is expected that the US crude oil exports may reach 4 million barrels per day by the end of the year, rising towards 5 million barrels per day during 2020. This will generate additional mid-sized tanker demand for direct exports to Europe on both Suezmax and Aframax vessels, as well as Aframax lightering demand for exports to Asia on VLCCs.

Lastly, we note the global oil markets remain finely balanced with oil inventories hovering around the five-year average. We therefore expect that OPEC may start returning barrels to the market during the second half of the year in order to keep the market well supplied as demand rises, which will be a further positive for tanker demand. However, the political situations in Iran, Venezuela and Libya remain wild cards and could create some volatility for rates during the remainder of the year.

Turning to slide six, we take a look at tanker fleet fundamentals. Tanker fleet growth is expected to slow considerably in the second half of 2019 onwards as the order book rolls off. The mid-size tanker order book, when measured as a percentage of the existing fleet, currently stands at just below 8%, which is the lowest in over 20 years. Furthermore, there are a large number of older ships in the world fleet, which will likely face scrapping in the coming years.



This is illustrated by the chart on the top right of the slide, which compares the size of the Suezmax and Aframax order books to the fleet of older vessels. Clearly, the fleet of older vessels that face scrapping is far larger than the current order book, which supports our view of continued low fleet growth in the coming years.

The chart on the bottom of the slide shows our forecast for Suezmax and Aframax fleet growth out to 2020. Fleet growth this year is expected to be higher than last year due to low scrapping levels. However, much of this growth has already taken place during the first four months of the year, particularly in the Suezmax sector where 22 out of the 28 vessel due to deliver in 2019 have already entered the trading fleet.

Fleet growth should therefore be far lower in the second half of the year, and will be further offset by vessels being removed from the fleet for the installation of scrubbers. In 2020, we're forecasting less than 1% growth in both the Suezmax and Aframax sectors, paving the way for a more sustained tanker market recovery.

Turning to slide seven, we look at our tanker fleet utilization forecast out to 2020. The chart illustrates our view of an improving freight market this year and next, a strong demand growth spurred by IMO 2020, and an increase in long haul oil movements is expected to outstrip fleet growth by a considerable margin. This should lead to higher global fleet utilization, which should drive a much firmer tanker market, starting in the second half of 2019.

Turning to slide eight, although rates have declined from the highs reached at the end of 2018 and the first quarter of 2019, our crude tanker spot rates in the second quarter of 2019 to date are much stronger than the second quarter of 2018. Based on approximately 61% and 55% of spot revenue days booked, Teekay Tanker's second quarter to date Suezmax and Aframax bookings have averaged approximately \$17,300 and \$21,200 per day respectively.



For our LR2 segment, with approximately 54% of spot revenue days booked, second quarter to-date bookings have averaged approximately \$15,000 per day. As you'll note in Appendix, of this presentation on slide 17, Q2 is a heavy dry-docking quarter[?], 10 vessels and 301 days of off-hire projected. This proactive planning of required dry docks will help us to have these vessels available to maximize our earnings and cash flow during what we believe will be affirming freight market starting in the second half of the year.

In closing, given our previously mentioned near-term outlook for spot tanker market headwinds, the losses incurred over the last two years and the incremental debt the company has taken on from recent financing transactions to improve our liquidity position, we intend to continue prioritizing paying down debt in 2019 before resuming dividend payments. If the market continues to strengthen, as we anticipate, in 2020, the excess cash flow will allow us to broaden our capital allocation options to include a resumption of dividend payments and potential share buybacks, in addition to further deleveraging, all of which aligned with our commitment to drive value creation for our shareholders.

With that operator, we are now available to take questions.

Operator: Thank you. If you'd like to ask a question, please signal by pressing star one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, please press star one to ask a question.

Our first question comes from Randy Giveans, Jefferies.

Randy Giveans: Hi, gentlemen, how are you?

Kevin Mackay: Good, thanks Randy.



Randy Giveans: Hey good. Couple of quick questions for me. Just about a minute ago there, you mentioned that delevering your balance sheet is going to take priority to any dividends in 2019. Just questions around that, what about share repurchases? How do those stack up against dividends? And then, also if there is a certain maybe quarterly net income level we should be looking for before you do payout dividends, or a certain balance sheet leverage ratio that needs to be eclipsed before you pay off dividends? Or how can we kind of quantify the timing of a dividend payment?

Kevin Mackay: I think to be very clear, what we have discussed with the board is, given what we have been through over the last two years and the need to take on the additional debt that we have, we felt that, as we look at 2019 as a year, it would be most prudent to reserve that – in our capital allocation, to reserve those funds directly for debt repayment. But that speaks to 2019. 2020, if the market continues to move as we anticipate it will, then obviously we – the conversations that we have with the board on a quarterly basis about capital allocation is going to discuss the resumption of the dividends.

But we also have other avenues that we can allocate capital to, and certainly share buybacks. If our share price continues to trade at a discount to its intrinsic value, it is definitely an option that we will look at, as well as further deleveraging. So, I think, in our capital allocation discussions, we look at a whole broad range of options that are available to us. But we felt that, given the current market, we've only really had two good quarters after two fairly tough years that we've had to increase our debt levels, we felt for 2019 it was prudent to suspend the dividend.

Randy Giveans: Got it, okay, so the full year. Okay, and then looking at your time charters, you chartered in an Aframax, you chartered out a Suezmax. Can you talk a bit more about that six months' time charter? Is that for storage or is that for multi-month operations? And then how do you see your fleet going forward, looking at 2020, balancing spot cargoes with time charters to extend you through maybe the upswing here in the next 18 to 24 months?



Kevin Mackay: Yeah, it's a good question because it does look odd that we're out-chartering and in-chartering at the same time, but really, that's how we balance our portfolio as we look at the forward market and where we think opportunity lies. So on the Suezmax, that decision was really made in the early part of the year when rates were still very firm. And on a seasonal basis, we were anticipating that Q2 would be weaker than Q1, as it is historically. So we took the opportunity to time-charter the ship out at a healthy number and lock in that fixed income. And that ship will probably roll off towards the summer here, which we felt was good timing to start then exposing that vessel to an increasing spot market.

The longer-term charter that we took on the Aframax, which doesn't deliver until later in the summer, that was, again, an opportunistic piece of business that we looked at, based on our forward view of the market in the latter half of 2019 and 2020, possibly 2021. So we felt that our projections for rates over that period allowed us to increase our exposure at a level that would give us a decent margin.

But it's something that we look at in terms of our trading portfolio and how much exposure we have to a spot market or to short-term volatility, and we make those decisions accordingly. Going forward, I think what you'll see is we roll off our fixed income charters as we moved through 2019. And that is a deliberate move so that we can maximize our exposure to the spot market as we move into, again, the second half of this year and all of next year.

Randy Giveans: Got it. That makes sense. I'll hop off and turn over. Thanks for the time.

Kevin Mackay: Thanks Randy.

Operator: Our next question comes from Jonathan Chappell, Evercore.

Jonathan Chappell: Thanks. Good morning guys. Kevin, on the chartered-in strategy, I'm assuming, given the focusing on deleveraging, that vessel acquisition is probably pretty low down on your hierarchy of the things to do with cash. So there's a lot of optimism in the market. What's the actual availability of



charter-ins that are at rates that you still think are attractive enough to add leverage to the cycle that way?

Kevin Mackay: Good question, Jon. Everybody is looking at the same tealeaves. As you said, there is a fair bit of optimism across the industry in terms of where the fundamentals are pointing to. So if I take a comparison between where we are today and where we were in late 2013, early 2014, I think there's more optimism now than there was then and, as such, owners rate ideas are firmer than what we saw in 2014.

But there are still owners and lenders out there with assets in the market that do prefer fixed income coverage. And on that basis, given our relationships, our penetration in the market, our pool partners, we've got different avenues that we tend to source out the odd opportunity that maybe the general market doesn't get to see.

But I think the rates are obviously higher than what we saw five years ago at this point in the cycle. But I think there's still some value there to be captured, but it's – we have to be very picky about where the ship is, what their consumptions are, whether we can – for example, on Aframax, whether that we can flip that vessel into our full service lighterage program, all different aspects of the decision making. So it's not something that we decide to go out and take five ships and then go just make five phone calls and we're done. We're having to be very selective about the assets we get and at the rates that we think will be profitable.

Jonathan Chappell: That makes sense. And then taking maybe a different tact here, if I look at your slide seven, that utilization, I know it's kind of imperfect here, we're eye-balling it, but strongest since 2008, is quite a robust market. Asset values should follow along, maybe not to the same magnitude but directionally. So if we look at your fleet, about a quarter of it will be 15 years old or older by next year. Do you foresee a situation where you maybe start monetizing some of the older assets as a way to



further accelerate the deleveraging in the balance sheet, while at the same time, unfortunately, giving up maybe a little bit of leverage to the cycle?

Kevin Mackay: Yeah, I think, obviously, prudent management of the company would dictate that we take a look at that. I think it's early days yet. I think the asset market has a bit of a runway to go here as well as the spot market. So I think we should not rush into those decisions. It is and has been raised with the board in terms of how we look at the market. And I think you will probably see us, as the market strengthens, start to use opportunities where we see value to add to the deleveraging the balance sheet.

But having said that just because a ship is 15 years old doesn't mean that we can't generate strong earnings with it, so we have to balance that with how much leverage we're taking out. So it's something that I don't think you'll see us do on-block, but I think we'll look at opportunities as and when they arise, and execute when we think there's value to be generated.

Jonathan Chappell: Okay, final one and this may be shorter, it may be a bit longer, but noticed this commentary about reimbursable staff costs related to an LNG terminal operations contract starting in mid-1Q 2019. Could you just explain what that means and how meaningful that potentially is?

Stewart Andrade: Sure, Jon. So for Q1, that amount is about \$1.5 million and that's simply a contract we have to manage an LNG terminal, we hire the staff and it's a flow-through cost to the entity that we're providing those services to. So it comes through both revenue and OPEX in the same amount.

Jonathan Chappell: Okay, so nothing to worry about going forward. All right, thanks Stewart, thanks Kevin.

Kevin Mackay: Thanks Jon.

Stewart Andrade: Thanks.



Operator: Our next question comes from Ken Hoexter, Merrill Lynch.

Ken Hoexter: Hey, good morning or good afternoon. I just wanted to follow-up on your sale-leasebacks. Have you thought about perhaps just selling part of the fleet to reduce the leverage and shrinking the fleet, or do you find synergies in the scale that are notable enough to keep the leverage that you need to keep working around?

Kevin Mackay: I think our decision making, when we did the sale-leasebacks, was based not only just on trying to bolster our liquidity position and strengthen our balance sheet as the market was soft, but it was also with a view to where the market was going to go. And selling assets at the bottom of the market is not something that any tanker owner wants to do.

So the option to do an outright sale wasn't very attractive. Whereas the sale-leasebacks, building in the purchase options at extremely low levels, allowed us the opportunity to get back into a position where we could extract more value out of that asset at some point in the future, while building up our liquidity when we needed it through the downside of the market. So given that the two comparables we found much better value in the sale-leaseback option.

Ken Hoexter: All right, that's helpful. Then, just I want to talk about the rates. Your rate commentary about starting to see softness as you moved into the second quarter, but you expect to bounce back. Just historically, when you get tensions like we recently had with US and Iran building up and moving warships around, don't you typically see rates tightening fairly quickly? Or maybe you can just give us a little history on as tensions increase, what you've seen in terms of rate movements?

Kevin Mackay: Yeah, whenever you have political strife, it tends to have an impact of varying degrees on the market. And I don't think you can compare individual past incidents with current incidents. Every time they occur, they occur for different reasons and with different impacts. The recent sabotage efforts that

we saw off the coast of Fujairah, they obviously heightened tensions and the international war group on the insurance side has now included those areas as war risk areas.

But in terms of the safety of traffic through the region, the reports from the security services and from regional governments appear to be that it's not a tension that is rising or that we would anticipate immediate escalation of the conflict. So I think the impact that we saw on rates was muted because it was dealt with somewhat quietly, and there was no further escalation over the coming week.

But certainly, that doesn't say that the next time it would happen, the impact wouldn't be stronger and the effect on the market wouldn't be greater. Every time it happens is different.

Ken Hoexter: It's helpful insight. Just usually something we've seen drive, I guess, depends on the length and scale of the tensions. When you look at the spot versus fixed rate, so you've got more than half of your days fixed for the second quarter. At what point – how do you think about that breakdown between near-term spot maybe building in longer-term rates? Is there a – are you looking for certain levels of Suezmax, Aframax pricing before you start looking maybe to lock in for – even if it's one year chartered-out outside of the spot market? Or do you want to keep all of that in the spot market until you get better multi-year rate?

Kevin Mackay: I think our view of the forward market, we wouldn't want to be locking in fixed rate income at the levels that we're seeing in the time charter market today. We think that would be giving away too much value. But certainly, as the market improves and as customers look to secure tonnage for longer periods at more attractive numbers, we'll certainly – that will be part of our portfolio decision making.

But I think to guide you today, I don't think you'll see us put ships out for 18 months, 2 years, 3 years; I think it's too early.

Ken Hoexter: All right, great, appreciate the thought. Thank you.



Kevin Mackay: Thank you.

Operator: Okay. At this time, I'll turn the call back over to Mr. Kevin Mackay. Please go ahead sir.

Kevin Mackay: Thank you very much for joining us today and we look forward to speaking to you next quarter.

Operator: Thank you, ladies and gentlemen. This concludes today's teleconference. You may now disconnect.