TEEKAY TANKERS LTD.

Moderator: Kent Alekson
August 12, 2010
12:00 pm CT

Operator: Ladies and gentlemen, thank you for standing by. Welcome to Teekay Tankers Second Quarter 2010 Earnings 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 1 to register for a question.

For assistance during the call, please press star 0 on your touchtone phone. As a reminder, this call is being recorded.

Now for opening remarks and introduction, I'd like to turn the call over to Mr. Bjorn Moller, Teekay Tankers President and CEO. Please go ahead, sir.

Kent Alekson: Before Mr. Moller begins, I would like to direct all participants to our Web site at www.teekaytankers.com where you will find a copy of the second quarter earnings presentation.

Mr. Moller 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 second quarter earnings release and earnings presentation available on our Web site.

I would now turn the call over to Mr. Moller to begin.

Bjorn Moller: Thanks Kent and good morning everybody and good afternoon in New York, I guess and thanks for joining us.

With me from Teekay Tankers in Vancouver is Mr. Vince Lok, Chief Financial Officer; Peter Evensen, Executive VP and also Teekay Corporations Corporate Controller, (Brian Fortier).

This morning, we're reporting on Teekay Tankers' results for the second quarter of 2010 and I'll begin with slide 3 of the presentation with our recent highlights. The company yesterday declared a quarterly dividend above the previously estimated range for Q2 of 34 cents per share just down slightly from the prior quarter. This dividend is payable on August 27, 2010.

During the quarter, our spot Aframax tankers earned an average TCE of $18,929 per day and our Seuzmaxes earned $30,942 a day. For the quarter, we earned adjusted net income of 7.6 million or 18 cents per share.

In April and July of this year, we completed a series of transaction that on a combined basis are expected to increase our illustrative run rate dividend by approximately 30% commencing with the third quarter's dividend. As a reminder, our illustrative run rate dividend assumes a spot Suezmax rate of 25,000 and a spot Aframax rate of $15,000 a day.

In the first of these transactions, in April and May, we acquired three modern ships and sold one older ship for net investment of $154.5 million. Two of the ships are on fixed rate time charters at attractive rates in excess of the current spot market. These vessel transactions increased our illustrative dividend by approximately 15%, and increased of financial strength because we used a greater percentage of equity to finance the acquisition.

In July, we announced that we had invested in two or 3-year first priority ship mortgage loans for a total of $115 million to a large Asian based ship owner to partially finance two (VLCC) (new buildings). The term loans earned interest at an annual interest rate of 9% or 10% including the repayment premium feature. We financed the loans using a portion of an undrawn facility which bears interest of rates – interest at a rate of LIBOR plus 0.6%.

Since we last spoke to you at the time of announcing this transaction, we have fixed a portion of the interest rates on the associated debt financing at an all-in interest rate of approximately 1.6% for a period of 2.4 years. Excuse me. We expect these loans to increase our annual dividend by approximately 20 cents per share during the 3 year term of the loans. I won't speak further on these transactions at this time because we've previously released individual presentations when they were announced.

However, should you have any further questions, please feel free to ask them during the Q&A portion of today's call. Finally, I will speak to the Tanker market in general and try to provide some insight into the current weak rates and to our – a more positive outlook for the upcoming winter market.

Looking at slide 4, we have provided a picture of our current fleet employment profile and updated the percentage of fixed rate coverage for the two transactions I spoke about on the previous slides. Two of the three ships acquired, the Helga Spirit and the Yamuna Spirit are trading on the fixed-rate charters. And we consider the two loans we made in July as being the equivalent of two ships trading on 3 year fixed-rate bareboat charters.

In total, we have 66% fixed coverage for the second half of 2010 and 43% for 2011. I believe a good way to summarize the strength for our fixed-rate portfolio is to consider that over the next four quarters, we expect that our fixed-rate revenues are substantial enough to exceed all of our costs and reserve requirements by approximately 13 cents per share. This means that those 13 cents plus all of our spot revenue can be paid out to shareholders.

Looking at slide 5, we illustrate how our recent transactions have raised the dividend flow, shown by the upward shift in the annual dividend payment from the dotted blue line which applied before the transactions to the new solid red line after the transactions.

In addition, the slope of the red line highlights the significant operating leverage from our spot trading fleet. Starting with the – from the revised illustrative base dividend of a $1.20 per share, again, our illustrative base dividend assumes spot Suezmax rates of 25,000 and spot Aframax rate of 15,000 a day. We have projected the dividend under various spot rate scenarios. Our illustrative dividend increases along the solid line by our current operating leverage which is 30 cents per share per annum, for each $5000 a day increase in spot (TCE) rates.

Next to the vertical axis, we have also shown the dividend yield that corresponds to various levels of dividend payments using our current share price. Unlike the purely illustrative slides I've just walked you through; the matrix on slide 6 provides our actual Q3, 2010 guidance on dividends.

For the quarter to date, we have booked approximately 50% of our Aframax and Suezmax spot revenue days at $13,500 and $19,000 a day respectively. Spot rates have continued to drop and are currently below these levels but fortunately our substantial fixed-rate coverage helps insulate us from the full effect of this market weakness, ensuring our ability to maintain an attractive dividend. As I'll discuss on the next couple of slides, we're expecting tanker demand to pick up in the upcoming winter, assuming we experience a normal seasonal demand pattern.

Turning this to slide 7, we examine some of the factors which explain the recovery in global oil demand and the resulting relatively firm tanker rates in the first half of 2010. Global oil demand goes hand in hand with the world economy with an 83% correlation between the two over the last few years. The current projection from the IMF is for 4.6% growth in the global economy during 2010 with emerging and developing economies leading the way.

As a result, global oil demand is expected to grow by 1.8 million barrels a day or 2.2% in 2010, the highest level of oil demand growth since 2004 and reaching a new all time record level. The outlook for both the global economy and the oil demand has become progressively brighter over the past year.

In April last year, the IMF was projecting total global GDP growth of just 1.9% in 2010 as the global economy was expected to recover very slowly from the financial crisis. However, the recovery has been much more rapid than expected and the IMF has raised its outlook for economic growth during 2010 in every subsequent update.

Similarly the outlook for oil demand growth has improved over time. In July 2009 when the IEA first released its 2010 oil demand outlook, the forecast was for 1.4 million barrels a day growth. In its latest assessment the IEA is calling for 1.8 million barrels a day growth, an increase of 30% from its initial forecast. The IEA has also recently released its first estimate for 2011 to oil demand growth at 1.5%.

Turning to slide 8, we look in a little more detail at the near term tanker demand dynamics. Crude oil import into of China in the first half of the year increased by 30% over the same period last year with Chinese ton mile demand growing even faster as China continues to source its crude oil from further afield in the Atlantic basin. Angola remains the number supplier of crude oil for China and imports from South America have also increased substantially year on year.

U.S. oil demands staged a recovery up 2% year on year in the first half and while there remains some question about the strength of the global economic recovery; looking ahead to the winter the chart on the top left highlights the firm outlook with winter oil demand forecast to be at its highest level in 3 years. In the short term though, floating storage of oil shown on the bottom chart has declined due to the erosion of the ((inaudible)) oil price play as well as the unwinding of the Iranian storage program.

Storage vessels returning to spot trading, we have seen a one-time increase in tonnage supply and this is what has hurt tankers rates in the third quarter to date. Having looked at the demand side, slide 9 examines what has been happening to the tanker fleet in the year-to-date.

In the first half of 2010 the global tanker fleet grew by around 12 million dead weight tons or 2.8% compared to 24 million tons or nearly 6% in the same period last year. The slowdown in tanker fleet growth is largely due to an increase in removals, particularly vessel scrapping as a result of the IMO phase out of single hull tankers which is coming into effect in earnest this year.

In addition we continue to see a relatively high level of slippage in the tanker order book with deliveries running about 25% behind schedule in 2010-to-date. Looking ahead we expect tanker fleet growth to come in at approximately 5% in 2010 down from 7.1% last year. This slowdown in fleet growth when combined with a stronger demand picture again helps to explain the relative strength in rates during the first half of 2010 compared to the low levels of last year.

Before we open up the call to questions I'd like to turn your attention to slide 10 which provides some preliminary details and our 2010 Investor Day to be held on Wednesday October 20 at the World Office Waldorf-Astoria Hotel in New York. At this event we'll provide a detailed presentation of the Teekay Group of Companies, covering the financial position and market outlook for each of Teekay Corporation, Teekay LNG, Teekay Offshore and Teekay Tankers.

The event will be webcast live for all interested current or prospective investors. And while this is still a couple of months off, we encourage everyone to mark their calendars and look forward to presenting a meeting with investors. I am now available to take questions. Thank you.

Operator: Ladies and gentlemen, if you'd like to ask a question, press star 1 on your touch tone phone. To withdraw your question, press the pound sign. If you use a speaker phone, lift your handset before entering your request. Please stand by for your first question.

Your first question comes from Jon Chappell of JP Morgan. Please go ahead.

Jon Chappell: Thank you. Good morning. Vince, on the dry-docking days, you've highlighted a lot of the dry-docking for Teekay Corporation in the earlier call. Was there any in the second quarter that impacted Teekay Tankers? And what's the schedule for the second half of this year?

Vince Lok: Yes, second quarter actually was higher than normal level of dry-docking for Teekay Tankers. So, we had two ships dry-docked for a total of 94 days. In the third quarter, a little lighter, we have one vessel for just under 20 days. And nothing scheduled for the fourth quarter and nothing scheduled for 2011.

Jon Chappell: OK.

Vince Lok: We've gotten through the heavy dry dock schedule in the second quarter already.

Jon Chappell: Would you mind saying which ships you had, the (Erik) Spirit in the second quarter? And I don't …

Vince Lok: The second quarter was the (Sotra) Spirit and the (Erik) Spirit and the third quarter is the (Matterhorn) Spirit.

Jon Chappell: Perfect. OK. This time I have another question on this – on the deal you announced a couple of weeks ago with the debt structure. This whole repayment feature that can bring it to 10%, is that something that should be assumed as kind of the base case, is it already set up so there's going to be this repayment premium that you're going to get 10% or is that only potential upside and 9% should be the base case we use?

Vince Lok: Well, it should be 9% on a run rate, but when loan is repaid, it'll turn out to be a 10% annualized return minimum. So, it'll come if it – on a 3-year maturity, you could figure where we'll get 9% for 2 years and then we'll get the 13%.

Jon Chappell: OK. That's helpful. And then finally just on TNK's potential fleet growth in the second half of the year, you said that from Teekay's perspective, you don't quite think the return to there for asset prices, clearly the cost of capital's a little bit different at TNK. Are you happy with the fleet, where it sits right now and your outlook for the market and for asset prices or would you expect some more fleet growth in TNK let's call it in the next 6 months?

Bjorn Moller: I believe we should expect to see an ongoing you know measure of growth in TNK and we'll be opportunistic. I think that there will be some attractive opportunities, so I would hope we can grow TNK. That's only the plan.

Jon Chappell: OK. Thanks, Bjorn, thanks, Peter and thanks, Vince.

Operator: Thank you. Your next question comes from Justin Yagerman of Deutsche Bank. Please go ahead.

Justin Yagerman: Hey, guys. When you think about acquisitions coming up, I mean is there a preference between dropdowns or third party purchases? You know when I think about buying vessels at potentially low asset prices and taking advantage of that type of a market, maybe you'd be more inclined to go out to third party as opposed to you know compensating the parent at lower levels or is that not a consideration?

Bjorn Moller: (Teekay) tankers' standpoint, there's no consideration that's completely a level playing field. Teekay will look at assets whether they come from the parents or from third party on the same basis. And that is very clear; we're very deliberate about that. So, I think it depends where the best transactions can be found.

Justin Yagerman: When you look at the composition of your current fleet you know would you think about going up or down in size or you know are we going to be focused on the Afras and the Suezmaxes? And I guess between the two assets classes, is there any inclination towards one versus the other?

Bjorn Moller: I would say no, I think that by the time (TNK) has grown in the next several years I think you'll find that (TNK) will be engaged across the spectrum of tankers.

Justin Yagerman: OK. Ships coming off charter in the back half of this year and early next, what are your thoughts that you know obviously you guys laid out some demand drivers? Should we expect to see a mix of time charters and some vessels left on spot or what kind of employment are we considering right now? And how far in advance would you consider doing time charters?

Bjorn Moller: Yes, we are very focused on the tactical management of the fleet and I personally believe that a mixture of spot and fixed will be in the best interest of our shareholders. We are playing it based on near term developments and the time charter market moves, the spot market moves.

And if you acquire assets, sometimes they come with a coverage. So, I think it's 43% I think is the number for 2011, already a pretty good base.

And we might still see you know some choppiness. So, we want to have some exposure to the upside. We ideally like deals that have a flow rate with profit share, and which we've been able to negotiate on the number of our charters. That's something that we like a lot.

Justin Yagerman: When you look at the market right now, what's the depth of the time charter market? Are you seeing longer term deals? Is it really just 1 year, and possibly you're going shorter and you know where are the rates relative to spot?

Bjorn Moller: So, tanker rates for time charter certainly held up better than the spot market, but today I think we've seen the spot tanker rates of Aframax in the North Sea jump significantly. So, obviously the volatility in the spot market means that these charters can be in and out of the money very quickly. There's not a significant traffic on the volume of deals beyond 1 year is pretty thin, but you can find selectively deals if you wish. So, it's a market that's been quite pretty active I would say in the last 3 or 4 months.

Justin Yagerman: OK. That's helpful and then lastly …

Peter Evensen: Wait, I would just add – I would just add just in that what we've been seeing on the time charter market is a lot of people – oil companies have wanted to take charters but on market related basis, in other words, floating. And that doesn't – and we're interested in fixed rate time charters, when we do time charters. And because we feel we can outperform a market related index.

Justin Yagerman: OK.

Peter Evensen: With are pool structures, so we haven't been attracted to that model.

Justin Yagerman: That makes a lot of sense, it's helpful color, thanks Peter. Lastly, just a quick one, you talked about swapping out part of the debt exposure on VL transaction, what – how much of that debt did you swap out? Is it the whole 115 or?

Peter Evensen: Yes, it's the entire 115, although we did a portion of that for 2 years and another portion for 3 years. So, the weighted average is 1%, so the all-in debt cost is 1.6% on that.

Justin Yagerman: Got it. All right, thanks a lot for the time guys, appreciate it.

Peter Evensen: Thank you.

Bjorn Moller: My pleasure.

Operator: Thank you. Your next question comes from Ken Hoexter of Merrill Lynch, please go ahead.

(Scott): Hi, guys. It's (Scott) in for Ken. Most of my questions were answered but just curious when you look back at having announced the investment in the two VLC loans, have you seen more of the same types of opportunities cross your desk since then? And was that an isolated opportunity because of the relationship or are you actively out there seeking other distressed investments like that?

Peter Evensen: Well, we have – speaking for all the companies but not for – and not for Teekay Tankers, we've been really actually surprised at the reverse inquiry. After we announced that transaction a lot a lot of new people have come to us. But that is not a transaction we would especially see down at Teekay Tankers, that's something we could look at some of the other companies.

But it only pointed out to us that there is a shortfall of debt finance in the tanker market right now and actually across the shipping spaces, the shipping banks have been sort of more impacted by the financial issues and especially the European banks who don't have a natural source of U.S. dollar funding. So actually, we're somewhat surprised about that.

But our basic view at Teekay Tankers is that we want to own and operate ships. And so, that's where you're going to find our sweet spot. We haven't deviated from that. This was just such a good opportunity we felt, and it put us into the VL market.

(Scott): Sure. OK and then, just a macro-based question. I mean, in going back to that release when you made the investment you mentioned that they provided an attractive risk adjusted return and I think it's pretty clear why that is. But when you think about growth right now in terms of adding vessels, can you comment on where you see the risks? Do you see the risks coming more from the demand side or from the supply side? Or is there a sense that vessel values have gotten ahead of themselves where we – given where we are right now from a rate standpoint?

Bjorn Moller: I think you have to look at two aspects. If you look at the pure upside downside issue around vessel supplies and vessel prices, I think that you have a large order book for 2011 and you have to expect that there will be some a little bit of indigestion on some of the tonnage even oil demand is expected to grow further.

On the other hand, look at Teekay Tanker's standpoint; we have a valuable currency that gives us the opportunity to make attractive investments. And so, I guess, we have a slightly – the flow is tilted a little bit in our favor.

(Scott): OK. Surely, that's helpful. Thanks a lot, guys.

Peter Evensen: Thank you.

Operator: Thank you. Ladies and gentlemen, if there are any additional questions, please press star 1 at this time. There are no further questions at this time.

Bjorn Moller: OK. Well, thank you very much for joining us and for your questions. And I hope to see you at our Investor Day in October and we'll talk to you again in November for this third quarter call. Have a great day. Bye-bye.

Operator: Ladies and gentlemen, this does conclude the conference call for today. You may now disconnect your line and have a great day.

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