TEEKAY TANKERS LTD

Moderator: Bruce Chan
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12:00 pm CT

Operator: Welcome to Teekay Tankers Ltd.'s Fourth Quarter and Fiscal 2013 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 questions participants will be asked to press star 1 to register for a question. For assistance during the call please press star 0 on your touch-tone phone. As reminder, this call is being recorded.

Now for opening remarks and introductions, I would like to turn the call over to Mr. Bruce Chan, Teekay Tankers Ltd.'s Chief Executive Officer. Please go ahead sir.

(Ryan): Before Mr. Chan begins, I would like to direct all participants to our Web site at www.teekytankers.com where you will find a copy of the Fourth Quarter and Fiscal 2013 Earnings Presentation. Mr. Chan will review this presentation during today's conference.

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 Fourth Quarter and Fiscal 2013 Earnings Release and Earnings Presentation available on our Web site.

I will now turn the call over to Mr. Chan to begin.

Bruce Chan: Thank you (Ron). Hello everyone and thank you very much for joining us. With me here in Vancouver is Vince Lok, Teekay Tanker's Chief Financial Officer, and Brian Fortier, Group Controller of Teekay Corporation.

During today's call, I will be taking you through Teekay Tanker's Fourth Quarter and Fiscal Year 2013 Earnings Results Presentation, which can be found on our Web site. Beginning with our recent highlights on slide 3 of the presentation, Teekay Tankers generated an adjusted net loss of 3 cents per share in the fourth quarter compared to an adjusted net loss of 5 cents per share in the third quarter.

Cash available for distribution or CAD was 12 cents per share in the fourth quarter, up from 10 cents per share in the third quarter. These increases were primarily due to stronger Suezmaxes and Aframaxes (spot) tanker rates earned in the fourth quarter and interest income recognized on our term loan investments secured by two modern VLCCs.

In accordance with our current fixed dividend policy, the company declared a fourth quarter dividend of 3 cents per share. This was Teekay Tankers' 25th consecutive quarterly dividend, which was paid on January 31 to all shareholders of record as of January 17. Since inception Teekay Tankers has paid a total of $7.30 per share in dividends. Teekay Tankers' dividend is currently fixed at an annual level of 12 cents per share payable quarterly.

During the fourth quarter, the company recorded a $14.9 million reversal of the previously recorded loss provision on its investment and term loans secured by two VLCCs. As a result of this reversal, the previously recorded loss provision associated with these term loans has been fully eliminated.

In January 2014, Teekay Tankers and Teekay Corporation jointly created and co-invested in Tanker Investments Limited, TIL, a new tanker company, which will seek to opportunistically acquire, operate, and ultimately sell modern second hand tankers to benefit from the cyclical recovery we believe has now begun in the tanker market.

Teekay Tankers and Teekay Corporation each invested $25 million for a combined 20% ownership interest in the new company. Also as previously announced, the Teekay Corporation and Teekay Tankers Boards of Directors agreed in principle to the sale of Teekay Corporation's conventional tanker commercial and technical management operations to Teekay Tankers. Upon completion of the sale, Teekay Tankers will receive the fee revenues that Teekay Corporation currently receives for commercially managing a fleet of 82 vessels and technically managing a fleet of 49 vessels.

In December 2013, the previously detained VLCC B Elephant, which secures one of the company's term loan investments was released by the Egyptian authorities. The vessel is now trading in the spot tanker market under Teekay Tankers' management and generating cash flow.

In January 2014, crew tanker rates briefly reached their highest levels since the third quarter of 2008 mainly as a result of higher crude oil imports into China, an increase in long-haul crude oil movements from the Atlantic base into Asia, and seasonal factors, which I will cover later in the presentation.

Turning to slide 4, I would like to take a moment to discuss Teekay Tankers' involvement in creating and co-investing in Tanker Investments Limited, or TIL. In January 2014, TIL completed a $250 million equity private placement in which Teekay Tankers invested $25 million for a 10% ownership interest I the new company. As a cofounder and sponsor of TIL, Teekay Tankers will have the right to nominate one of TIL's board members and will receive half of the 1.5 million warrants allocated in the transaction, which will vest and gain value as TIL shares increase to specific price levels.

As I noted in my opening remarks, TIL will focus on opportunistically acquiring operating and ultimately selling modern second hand tankers at the right time in the tanker cycle and will be managed by a dedicated management team here at Teekay. TIL's vessels will operate in Teekay's commercial pools along with vessels owned by Teekay Tankers and other owners providing additional scale to the Teekay managed commercial tonnage pools.

Initially, TIL's fleet will consist of four Suezmaxes tankers and four Aframaxes tankers, which TIL has agreed to acquire from Teekay Corporation and a third party vendor respectively between March and June this year. The remaining proceeds of over $100 million from the private placement will be used to acquire additional tankers and for general corporate purposes.

We are excited to play a role in the creation and growth of TIL, which provides shareholders of Teekay Tankers with an additional way to benefit from the appreciation and second hand asset prices associated with the cyclical recovery from the low tanker market of the last four years.

We believe our investment in TIL complements Teekay Tankers' existing core strategy of operating tankers to service our customers through the tanker market cycle, which includes the strategic renewal of our fleet through both new building and second hand asset purchases and actively managing our market exposure through a combination of in charter opportunities and fixed rate out charters.

Upon completion of Teekay Tankers' acquisition of Teekay Corporation's conventional tanker technical and commercial management operations, Teekay Tankers will be able to generate fee revenue from the management of both TIL and third party vessels. In summary, Teekay Tankers now has the flexibility to either directly invest in second hand tankers or invest in future growth of TIL.

Turning to slide 5, I will provide an update on Teekay Tankers' term loan investments secured by two 2010 built VLCCs. As mentioned in my opening remarks, B Elephant was released by the Egyptian authorities in December 2013 after which Teekay Tankers took over commercial and technical management of the vessel and began trading her in the spot market.

Both vessels securing our term loan investments are now under Teekay Tankers' management with all accrued earnings going towards the full repayment of the amounts owed to Teekay Tankers under these loans.

In the fourth quarter, as a result of the general increase in vessel values, Teekay Tankers recognized $2 million of interest income and recorded a $14.9 million reversal of the loan loss provision previously recorded on this investment. Based on current estimates, Teekay Tankers now expects to recover the full carrying value of the loans including the principle balance, redemption premium, accrued interest, and out of pocket expenses incurred to date.

This is of course in addition to the 9% per annum interest income we have already received during the first two and a quarter years of our $115 million investment. While we work through the process with the borrowers and second priority mortgagees, our plan is to continue trading the vessels on the spot tanker market while we evaluate our options for monetizing the vessels and maximizing the return on our investment.

Turning to slide 6, we take a look at the recent developments in the crude tanker spot market. As shown by the chart on the slide, average global spot rates for Suezmaxes and Aframaxes tankers reached a five-year high of approximately $75,000 per day and $65,000 per day respectively in mid-January 2014 with earnings on certain routes exceeding $100,000 per day.

This winter spike is unlike anything we've seen since the financial crisis of 2008 and 2009 and is a reflection of both tightening fundamentals and strong seasonal factors.

Starting with the fundamentals, in the last few months, we have seen very high oil demand in both the developed and developing world, which has boosted demand for crude tankers. Chinese crude oil imports hit a record high of 6.6 million barrels per day in January 2014 driven by a combination of new refining capacity and stockpiling.

Much of this oil has been flowing from the Atlantic Basin, including West Africa and Latin America, which is positive for tanker ton-miles due to the long haul nature of such trades. Demand has also been strong in the developed world with the IEA reporting that oil inventories in the OECD declined by 1.5 million barrels per day in the fourth quarter of 2014, the steepest quarterly decline since 1999.

This is partly due to the extremely cold weather seen in parts of North America but is also a reflection of better levels of underlying demand than were previously forecast.

In addition to the strong demand fundamentals, several seasonal factors boosted crude tanker spot rates during December and January. This was particularly true in the Atlantic Basin where winter weather conditions in the Black Sea, Mediterranean Region, and the U.S. Gulf led to severe vessel delays and a sharp increase in rates as charters searched for replacement tonnage.

Turning to look at slide 7, we look at developments in the product tanker market. Earnings in the product tanker sector have been steady in recent months showing less volatility than crude tankers. However it is important to note that while product tanker rates have not spiked like crude rates, they have nevertheless provided stable returns through the tanker market downturn and at times have outperformed the crude sectors despite their smaller ship size and lower levels of invested capital.

It is also important to note that Teekay Tankers has been able to outperform industry benchmarks through the use of its commercial pools including the Taurus tankers LR2 pool. The use of pools allows us to achieve higher levels of fleet utilization due to the scale such pools afford, including the ability to minimize time and (balance) through triangulation.

For the Taurus pool, we were also able to beat industry benchmarks because of our ability to keep some vessels in the dirty Aframaxes (trade), to take advantage of spikes in the crude market. You can see from the chart on the top left hand part of the slide that by moving some ships into the strong dirty Aframaxes trade in recent weeks we were able to elevate our LR2 earnings above the clean industry benchmark, which will be reflected in our first quarter 2014 results.

Looking ahead to the rest of 2014, demand fundamentals in the product sector remain strong. We believe that this will continue to drive up fleet utilization and therefore rates through the course of the year. In particular, the startup of new refining capacity in the Middle East and Asia and the continued closure of refineries in Europe, Japan, and Australia are expected to create new trade routes for refined products, which will benefit product tankers.

Turning to slide 8, we look at improving crude oil demand fundamentals and the expected impact on the tanker market in 2014. As shown by the chart on the slide, the outlook for global oil demand has improved significantly since the middle of last year with the IEA revising its 2014 oil demand forecast up from 92 million barrels per day in its July 2013 report to 92.6 million barrels per day in its most recent February 2014 forecast. This is in contrast to recent years when the trend has been for market forecasters to overshoot their estimates on oil demand and to revise their forecast downwards during the course of the year.

The stronger outlook for oil demand is due to an improving economic outlook, particularly in the developed world where sustained recovery seems to be finally taking hold. This positive outlook is reflected in the recent publications from the IMF and the World Bank, both of which published upbeat reports in January with an improved outlook for global GDP growth in 2014 and beyond. This improved outlook for global oil consumption should translate into stronger tanker demand during 2014, which combined with low levels of fleet growth is expected to drive tanker fleet utilization higher in the coming months.

The improved demand outlook is reflected in the chart on slide 9, which shows our forecast for tanker fleet utilization for 2014 and 2015. The dark blue bars o the chart show tanker demand growth while the red bars show tanker fleet growth. The green line shows tanker fleet utilization, which is simply tanker demand, divided by tanker supply. As you can see in the chart, tanker fleet utilization has been in the low 80% range since 2011 is this has coincided with a period of very low tanker rates. However, we believe that 2013 will prove to be the trough of the market and that utilization will improve from 2014 onwards as demand growth begins to outweigh supply growth.

We are currently forecasting tanker fleet growth of just over 1% in 2014, the lowest level of fleet growth since 2001. As outlined in the previous slide, tanker demand growth is expected to accelerate this year due to better underlying levels of oil demand as the global economy continues to recover. This is expected to give rise to tanker demand growth of approximately 3% in 2014 meaning that overall fleet utilization is forecasted to increase by approximately 2%.

For 2015, the trend is similar with fleet growth again expected to come in at just over 1% while demand growth improves to around 3% to 4%. This means that over the next two years we expect tanker fleet utilization to return to the mid 80% range or higher, which in turn should mean an improvement in spot tanker rates compared to the very low levels seen in recent years.

In summary our view of the fundamentals is that we are at a cyclical turning point for the tanker market with a better supply demand balance forming the basis for a sustained tanker market recovery in the coming months and years.

Turning to slide 10, as I touched on a few slides back, spot tanker rates have increased considerably in the first quarter of 2014. Compared to the averages for the fourth quarter, first quarter to date realized Suezmaxes and Aframaxes rates have been significantly higher and LR2 rates have also improved slightly from the fourth quarter.

Based on approximately 65% of spot revenue days booked, our first quarter to date Suezmaxes bookings have averaged approximately $34,300 per day significantly up from the $15,200 per day in the fourth quarter. And our first quarter to date Aframaxes bookings have averaged approximately $25,300 per day up from the $13,900 per day in the fourth quarter. Based on approximately 75% of spot revenue days booked our first quarter to date LR2 bookings have averaged approximately $14,700 per day up from $12,900 per day in the fourth quarter.

While our average booked rates in the first quarter to date are considerably higher than several previous quarters, rates have been softening over the past few weeks and current spot rates are substantially lower. Nevertheless based on our bookings for the first quarter to date, we expect that our earnings and cash flow in the first quarter of 2014 will be much improved over the fourth quarter of 2013.

Despite the recent cooling of spot tanker rates we are encouraged by the rates achieved in the tanker market over the past couple of months, which we believe points to a general tightening in the supply demand balance for crude tankers and a signpost of the beginnings of a meaningful market recovery.

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

Operator: Thank you. If you would like to ask a question, please signal by pressing the star key followed by the digit 1 on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. If you have signaled for a question prior to hearing these instructions on today's call please repeat the process now by pressing star 1 again to ensure our equipment has captured your signal.

And our first question comes from Jon Shappell with Evercore. Please go ahead.

Jon Shappell: Thank you. Good morning Bruce.

Bruce Chan: Good morning Jon.

Jon Shappell: I wanted to talk about the Teekay operations to see if there is any more clarity you can provide around that. First of all, when is that acquisition supposed to close? And then second of all, the fee revenue from operations. Is there any way to kind of give us obviously not forward guidance but what that fee revenue for the technical and commercial management of those pools was for Teekay Corp let's say in 2013?

Bruce Chan: On your first question Jon, it's expected that the transaction would close in Q2. And in terms of guidance, we can probably give a little bit better offline, but as you know, commercial pools charge 1.25% of gross rates and a couple hundred dollars a day, you know somewhere between $200 and $300 a day for administration costs. And so, that's kind of their revenue line and then there is obviously associated costs with that, but I can't really give you much more than that at this time.

Jon Shappell: Okay and then the TIL part of that operations business let's call it. Is it fees for just the gross rates, but it sounds like this business is going to be a little bit more of sale and purchase opportunistic. Is there any fees associated with S&P activity for the owned tonnage and then with TIL?

Bruce Chan: Yeah, the fees are kind of split, so the commercial and technical will be owned by TNK and so those fees will accrue to TNK. On the S&P side, that will accrue to our overall sponsor, which is still Teekay Corp.

Jon Shappell: Okay, got it. And then if you could just explain a little bit more. You know TIL wants to be very nimble, opportunistic, et cetera, but where is TNK's kind of growth initiatives come from now? Is it really competing against TIL or do you see you know growth more through just the return of the cycle and you know the fees from the operations business? Is there really a lot of growth potential directly for TNK?

Bruce Chan: Well TIL is an enhancement of that growth for TNK and its ownership and the participation in the warrants. But as you say TNK's growth is the return of the cycle and enhancing that potentially through additional in charters and the timely renewal of the fleet. But so we do see there being more opportunities at TNK in addition to the benefit of being an investor in TIL.

Jon Shappell: Final one on the two VLCCs. I know you probably don't want to say any timing about when you would sell them. Just trying to figure out the modeling of those. You mentioned in your prepared remarks that there is interest income associated with that, so are they going to show up as you operate them and generate cash flow especially in the strong VL market in your revenue line, in your operating expenses line, or is there just going to be an operating income line associated with that.

Vince Lok: Hi Jon, it's Vince. As of right now, these loans are still sitting as loans receivables with the book value of $136 million. Should the values change that potentially results in additional interest income recognized in our revenues. However if we were to take ownership of the vessels, then they would switch from being a loan receivable into you know vessels on the balance sheets and that would change the accounting for that. But as of right now, they are still sitting at loans receivable right now.

Jon Shappell: Okay and how are the conversations going with the second mortgages or whatever? I mean you know we've talked about this in the past. This was a unique opportunity for you. It looks like it is going to end up paying off, but VLCCs aren't your core competency really in the crude tankers, but you are more of a midsized operator.

Do you ideally hope to dispose of these at some point? Or you know given your views on the cycle, do you hold onto them a little bit longer?

Vince Lok: Yeah, well our discussions with the other mortgagees is clearly defined through our coordination agreement, so that's an ongoing clear process. And then in terms of the future, again, I mean you are right. We would ultimately like to deploy this capital in our core segments of Aframaxes or Suezmaxes, but the timing is not one that we need to take immediate action. So it would be a balance between finding the right time and the right buyer for these assets or in the meantime we have the luxury of being patient and generating cash flows on the spot market.

Jon Shappell: Okay, understood. Thanks a lot Bruce. Thanks Vince.

Bruce Chan: Thanks Jon.

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

(Taylor Mulhern): Hi guys, this is (Taylor Mulhern) on for Justin this morning. How are you?

Bruce Chan: Hi (Taylor), good, how are you?

(Taylor Mulhern): Good thank you. So I just wanted to follow up quickly on TIL just to get a little clarification. I understand there are different strategies between the two companies, but could you just elaborate a little bit on how you know any conflicts if there were an opportunity come up of a vessel that could potentially be attractive to both you now companies. How would something like that be resolved?

Bruce Chan: Yeah I mean fortunately, the sandbox is quite large out there for a number of ships so we don't anticipate a lot of conflict or very little conflict. But if there were rare opportunities where both companies were looking to buy assets, we would certainly work together and not be out there ensuring that we don't bid up the price for third parties. We would be looking to obtain the best value for ships amongst the whole Teekay group.

(Taylor Mulhern): Got it. And then just a couple of questions about the market in general. Obviously the market has been pretty strong you know in Q4 and then earlier in Q1 that's come off a little bit lately, but I wanted to ask you is there sort of a lag affect from what we see in the market when we just look at post rates versus what actually hits the bottom line for Teekay Tankers. And then if there is one, basically how long is that usually?

Bruce Chan: Yeah, there is certainly a lag affect. What you read in the market reports but then the voyages don't usually start for a few weeks and counting then accrues over form discharge-to-discharge port basis, so the lag is both two to three weeks maybe or roughly.

Vince Lok: Yeah, that's usually the lag.

(Taylor Mulhern): Got it. Okay and then my last one is you know you talked about how you are more focused on the midsized Suezmaxes and Aframaxes vessels more than VLCCs. Is there something included or there must be something that you find more attractive about those sized vessels. Maybe you know certain trade's lanes appear more attractive. You talked about the Atlantic to Asia route. Could you just sort of elaborate on what you are seeing in those specific trade lanes for those vessel sizes?

Bruce Chan: Sure (Taylor). Our general overall view is that the larger tanker segments, Aframaxes, Suezmaxes, and VLCCs are largely correlated. And so, the reason over time - and so the reason we like Aframaxes and Suezmaxes is because that's our area where we have the scale.

We operate our own commercial tonnage pools for both of those segments where we combine our ships with other people's ships and therefore have the ability to triangulate and have higher utilization and therefore outperform the market in those areas as well as our customer relationships or people looking for those sized segments.

And finally, those segments tend to also offer particularly Aframaxes a greater ability to trade through charters in and out and so those are the reasons why we like it. But overall, those markets generally are correlated.

(Taylor Mulhern): Great. Thanks for your time.

Bruce Chan: Thanks (Taylor).

Operator: Thank you. Our next question comes from Fotis Giannakoulis with Morgan Stanley. Please go ahead.

Fotis Giannakoulis: Yes, good afternoon, and thank you. A couple of questions about - if you could give us a description of how the flows have changed since the beginning of the year. We saw the rates spiking towards the end of ’13 and early ’14, and lately, the rates have come down. What was the reason for this significant volatility?

Bruce Chan: Yeah, I mean hi Fotis. It’s a combination as we said of seasonal and the fundamental shift. I mean January was one of the highest months for imports in China and those barrels are going to West Africa, Latin America out to South America, to the East, and so we had a combination of those types of fundamental increases in oil supply. And then as well, the seasonal factors such as you know timing of refinery maintenance now kicking in in the spring causes those markets to come down and the diminishment of certain of those weather delays that you would have seen more in the winter. So it’s a combination of those two factors that caused that spike.

Fotis Giannakoulis: Thank you. So I see the graph with your performance and it is clearly much higher than what the market average. You gave us an explanation about the LR2 vessels trading in the dirty space. What is the reason that you have such a good outperformance on that segment?

Bruce Chan: So the MR segment again is because the benchmark rate there tends to be on various route specific as opposed to the triangulated route and I know you published in yours a triangulated route MR and that’s a much better benchmark. And so our earnings obviously reflect the actual triangulation of those MR ships trading in a large pool and that’s the one pool that Teekay doesn’t operate. We trade in a third party pool, but it has significant scale. And again, we benefit from that scale and triangulation.

Fotis Giannakoulis: and can you give us an outlook for the product tanker market for the rest of the quarter? Do you see it improving versus the beginning of the quarter? That seems to have started at a much weaker pace.

Bruce Chan: Yeah, as we said in the prepared remarks, the product tanker markets tend to not have the big spikes. They have been more stable. And we see that continuing. The underlying fundamentals are still good and the general theme of that increased demand for product tankers we believe is still intact, but that market just traditionally hasn't seen that significant rate volatility that the crude markets have.

Fotis Giannakoulis: Thank you. One last question about the TIL investment. What was the reason that Teekay invested together with TNK in this new venture? Was the capital of Teekay necessary? Why this complicated structure?

Bruce Chan: Well I can't speak for (Peter) of Teekay Corp, but the contribution of the four Suezmaxes were the last owned conventional ships from Teekay Corp, helping it transform its model of having all of the assets at the daughter companies. And so, that was the contribution there from Teekay Corp. And then from TNK's perspective, it's the ability to invest in second hand tankers and increase the exposure for our shareholders at TNK to the return of the tanker market.

Fotis Giannakoulis: Thank you.

Operator: Thank you. And there are no additional questions at this time. Please continue.

Bruce Chan: Thank you (Tracey) and thank everyone for joining us this quarter. We will speak to you next quarter.

Operator: Ladies and gentlemen, this concludes the conference call for today. We thank you for your participation. You may now disconnect your line and have a great day.

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