TEEKAY CORPORATION'S SECOND QUARTER 2018 EARNINGS RESULTS CONFERENCE CALL

Company: **Teekay Shipping (Canada) Ltd.**

Date: **Thursday, 2nd August 2018**

Conference Time: **14:00 ET**

Operator: Please stand by. We're about to begin. Welcome to Teekay Corporation's Second Quarter and 2018 Earnings Results Conference Call. During the call, all participants will be in a listen-only mode. Afterwards, you'll 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 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 would like to turn the call over to Mr Kenneth Hvid, Teekay's President and Chief Executive Officer. Please go ahead, sir.

Lee: Before we begin, I'd like to direct all participants to our website at www.teekay.com where you'll find a copy of the second quarter 2018 earnings presentation. Kenneth 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 2018 earnings release and earnings presentation available on our website. I will now turn the call over to Kenneth to begin.

Kenneth Hvid: Thank you, Lee. And thank you all for joining us today for Teekay Corporation's second quarter 2018 earnings conference call. I'm joined today by our CFO, Vince Lok.

Starting with slide three of the presentation. In the second quarter, Teekay Corporation generated total consolidated cash flow from vessel operations, or CFVO, of approximately $164 million and a consolidated adjusted net loss of approximately $22 million or $0.21 per share.

Our results significantly improved compared to the same period of the prior year. This was primarily driven by higher cash flows from Teekay Parent's three directly owned FPSO units that have upside exposure to oil prices and production volume as well as the delivery and contract start-up of several growth projects across the group. Our improved results were partially offset by weaker spot crude oil tanker rates.

As a reminder, since we deconsolidated Teekay Offshore on 25th September of last year, our consolidated CFVO in the second quarter only includes 14% of Teekay Offshore's CFVO, whereas in the period prior to the fourth quarter of last year, it included 100% of Teekay Offshore's CFVO. Had we continued to consolidate Teekay Offshore, our reported total CFVO would have been approximately $307 million in the second quarter of 2018 compared to $254 million in the second quarter of 2017.

Lastly, it is important to note as a result of adopting the new revenue accounting standard at the beginning of 2018, we were required to gross up certain revenues and expenses resulting in an increase of approximately $68 million in voyage expenses and approximately $20 million in vessel operating expenses in the second quarter of 2018. But this had no impact on the bottom line since revenues increased by the same amount.

Also in the quarter, Teekay Parent generated adjusted CFVO of approximately $17 million, which includes CFVO from our directly owned assets and cash dividends and distributions from our publicly traded Daughter Entities. Teekay Parent's CFVO also significantly improved compared to the prior year's second quarter due primarily to higher cash flows from our three FPSO units as I just mentioned.

Lastly, in July 2018, we secured a one-year charter contract extension for Teekay Parent's directly owned Banff FPSO to August 2019, with Canadian Natural Resources on the Banff and Kyle fields in the UK sector of the North Sea. The new contract extension has a slightly lower fixed charter rate but has upside from a formula based on both oil price and production, which I'll touch on in more detail on the next slide.

Turning to slide four. With the completion of the charter contract extension for the Banff FPSO, our results continue to benefit from stronger oil prices from these assets, all of which have contracts that have fixed charter rates with upside exposure to both oil prices and production at oil price levels starting from $45 per barrel.

As highlighted on the graph at the bottom of this slide, our current quarterly CFVO can range from roughly $10 million to $20 million at oil prices between $65 and $85 per barrel. This is expected to be even higher in the fourth quarter as we expect to recognise additional incentive-based revenue from the Foinaven FPSO in the fourth quarter.

Turning to slide five. Over the past year, we have focused on de-levering Teekay Parent's balance sheet and continue to make good progress. In the second half of 2017, Teekay Parent and Teekay Offshore completed its strategic transaction with Brookfield, which brought in $140 million in cash plus TOO warrants to Teekay Parent and eliminated various Teekay Parent financial guarantees to Teekay Offshore.

In early 2018, we completed a convertible note and common equity transaction. Since the beginning of March 2018, Teekay Parent has repurchased approximately $53 million of its 8.5% senior notes due in 2020 at an average price of 103.97, which is below current levels and well below the make-whole price.

And most recently, we entered into an agreement to sell our ownership interest in Sevan Marine ASA for approximately $28 million, which is expected to close in the second half of 2018 and result in an expected accounting income or gain of approximately $13 million.

Since the second quarter of 2017, we have reduced our net debt from approximately $670 million to approximately $450 million on a pro forma basis. Looking ahead, we continue to focus on strengthening our balance sheet through our growing adjusted CFVO of Teekay Parent's FPSOs and the potential sale of these FPSO units which are currently debt-free. We believe that these assets have a higher value as a result of a stronger energy market.

I'll just briefly review the next three slides on our Daughter Entities, as I will assume most of you listened in to their respective earnings calls earlier today. On slide six, we have summarised Teekay LNG's recent results and highlights and the status of its growth projects. Teekay LNG Partners generated total CFVO of $115 million and distributable cash flow, or DCF, of $31 million, resulting in DCF per limited partner unit of $0.39.

As expected, the partnership experienced another quarter of increased earnings and cash flows from its LNG carriers from the delivery of various growth projects over the past several months. Unfortunately, the results from the seven multi-gas carriers the partnership took back in late 2017 due to non-payment of charter hire are continuing to underperform and have continued to significantly impact its quarterly results.

Since March, Teekay LNG has taken delivery of three LNG carriers, all under long-term contracts with Shell. To date, the partnership has taken delivery of approximately $120 million of the $310 million of total CFVO growth. In addition, Teekay LNG's midsized LPG joint venture with Exmar has now successfully completed its current fleet renewal programme.

Looking ahead, Teekay LNG will take delivery of nine LNG carriers and commence operations on the Bahrain regas terminal, which will further drive cash flow growth and the de-levering of its balance sheet. Our LNG team has also successfully refinanced its remaining 2018 secured debt maturities and continues to progress the refinancings of the remaining 2018 and 2019 maturities which we expect to complete later this year.

Lastly, we continue to see improving rates for LNG carriers. Spot charter rates for 160,000 cubic metre LNG carriers were on average 63% higher year-over-year in the first half of 2018, reaching a high of nearly $90,000 per day in June according to Clarksons. Demand was driven by strong Chinese imports, which were almost 50% higher in the first half of 2018 compared to the same period of the prior year.

Teekay LNG was able to take advantage of these elevated spot rates when our Teekay-Marubeni joint venture takes the Magellan Spirit in June to an Asian charter in the region of $90,000 per day.

Turning to slide seven. Teekay Tankers reported total CFVO of $17 million and an adjusted net loss of $29 million or $0.11 per share. OPEC supply cuts, a further drawdown of global inventories and an oversupply of tanker tonnage, continued to weigh on crude tanker rates during the second quarter. We continue to believe that an inflection point will be reached in the latter part of 2018 due to improving demand fundamentals and slowing fleet growth resulting from elevated scrapping and a shrinking midsized tanker order book. The improved tanker market fundamentals is expected to be further strengthened by positive demand developments ahead of the new IMO fuel regulations in 2020.

Since reporting earnings in May, TNK has continued to pursue various initiatives to improve its liquidity position during this period of week tanker rates. Upon completion, its current financing initiatives will bolster its liquidity position by approximately $110 million through two sale lease transactions and a new working capital loan. On a pro forma basis for the completion of these financings, TNK's total liquidity position would be approximately $190 million as 30th June 2018.

In what is typically the weakest quarter of the year, we have seen improvements in crude spot tanker rates in the third quarter to date compared to the second quarter. In recent weeks, we have seen the return of some volatility to midsized tanker rates. This is particularly evident in the Atlantic Basin, with Aframax rates in the Mediterranean and UK continent exceeding $20,000 per day at times. We believe that increasing oil production from Russia and Saudi Arabia, coupled with rising export from the US, are driving this volatility.

Looking at slide eight, we have summarised Teekay Offshore's recent results and highlights and the status of its growth projects. Teekay Offshore Partners generated CFVO of $162 million and DCF of $25 million resulting in DCF per limited partner unit of $0.06.

In July, Teekay Offshore entered into further contract extensions on the Voyageur Spirit and the Ostras FPSOs, which would result in higher rates in subsequent charters – in subsequent quarters, apology – commencing in July 2018 for Ostras and January 2019 for Voyageur Spirit. Also in July, the partnership refinanced its 2019 bond maturities and a 2022 promissory note with a new $700 million unsecured bond.

Last week, Teekay Offshore ordered two LNG fuelled DP2 shuttle tanker newbuildings for delivery in late 2020 and early 2021, which I expect it to further strengthen its position as the leading provider of contract of affreightment, or COA, shuttle tanker services in the North Sea. These newbuildings, along with our four existing newbuilds under construction, are based on Teekay's New Shuttle Spirit design, which uses proven technologies to increase fuel efficiency and reduce emissions through the use of LNG as a fuel.

Lastly, strong oil prices continue to drive investment by our customers, which is expected to increase demand for offshore production, storage and transportation assets. Wrapping up, we continue to make progress on strengthening the financial foundation across the Teekay Group while maintaining our market-leading positions and strong operating platforms. And we believe that the Teekay Group is positioning to benefit from a continued broader energy and tanker market recovery.

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

Operator: Thank you. Ladies and gentlemen, if you'd like to ask a question at this time, please press star one on your telephone keypad. If you're on a speakerphone, please make sure that your mute function is turned off to allow your signal to reach our equipment. Once again, for questions at this time, please press star one. And we do have a question from Sam Cho with Wells Fargo Securities.

Sam Cho: Hey, guys. Good afternoon. Just assuming the strategy at the parent level and the kind of policy of trying to move assets off hasn't changed and Brent's sitting in the mid 70s, can you provide us an update on kind of what the sale conditions look like for the three FPSOs?

Kenneth Hvid: Hi, Sam. Yes, I think this has been a recurring theme, I'll say, over the past number of years. And as you will recall after the oil price dropped, we said we had to sit on these assets for quite some years until we saw the oil market recovering. What we've been focused on now is really improving some of the underlying contracts as we've done both on the Hummingbird and Banff as we reported this quarter.

And that, of course, makes these assets more interesting. We see our customers are investing in existing fields. We see new interest coming in and we are out talking about various alternatives for these assets now. So, I would say now is the time and that we are encouraged by the conversations we're having. But I can't really share more details on that at this point.

Sam Cho: Sure. You touched on this a little bit but you're clearly on a noticeable path to delevering. Is there a target net debt number you have in mind by this time next year? You've made some pretty significant progress and kind of as we look at the ability of the parent to support the daughters, kind of how much capacity they have. That could be kind of useful as a metric.

Vincent Lok: Hi, Sahm, it's Vince. Yeah, you're right. As you've seen, we've been able to chip away at our debt at the parent company and you've seen us repurchase some of our bonds recently as well. So, our 2020 bond is now $540 million. So, as Kenneth mentioned, in addition to the Sevan share sale, if we're able to execute on some of these FPSO sales as well as getting increased cash flows in these assets, that will help drive further de-levering. I think if we can get down to something that is sort of in the 250 to 300 range, I think that's where we would be quite comfortable with.

Sam Cho: And then, I guess, just my last question is I know we've revisited the capital allocation conversation pretty frequently. But as some of the growth projects that the daughters' kind of come into fruition, has there been any discussion on updating your dividends?

Kenneth Hvid: Yeah, if you listen then to – I think the one where – we also received that question every quarter – is particularly for TGP. And I think Mark Kremin on the call earlier today laid out how we're thinking about it. It's clear that the dividend capacity is growing and it's also clear that we're looking at the whole MLP space and the right way to structure that dividend. I think we've said over the past year that we would – we expect to come out in the fourth quarter of this year and give some guidance and we are – we're carefully evaluating that and – to come out with a new policy that's prudent, and so stay tuned for that.

Sam Cho: Great. And then you might have dropped out there, but did you have a timeframe for that type of announcement?

Kenneth Hvid: Yeah, fourth quarter.

Sam Cho: Okay, great. Thank you.

Operator: Our next question will come from Fotis Giannakoulis from Morgan Stanley.

Fotis Giannakoulis: Yes, hi, gentlemen and thank you. Can you give us a little bit more colour about the new contract of the Banff and how the oil-linked tariff works for this particular asset?

Vince Lok: Hi Fotis. I can't give specific details. They're commercially sensitive information. But there is a fixed rate component that generates positive EBITDA, and then there's oil-linked tariff that is tied to oil prices and production. So, that provides additional upside. The oil price link starts at about $45 and above. So, we get the upside from that level.

Fotis Giannakoulis: Thank you. And regarding the field, would you be able to share your views about potential further extension beyond 2019?

Kenneth Hvid: Yeah, I think when we had this call a year ago, I think we expected the Banff unit to go off station this year, actually this summer. I think a combination of strong gas production of – in particular on the field and, of course, a very different oil price environment resulted in the extension now. And it's always difficult to forecast production levels at mature fields but we've seen a pretty stable production over the past year. So, let's see same time next year, maybe there is an environment where we foresee further extensions. So far, we have similar production levels that we are seeing on our side at least.

Fotis Giannakoulis: Thank you. And one more question about latest orders. Vessels that are Aframax sized, how shall we think about the acquisition cost versus previous Suezmax vessels? And why Aframax size, is it just a diversification or it's a demand for customers? If you can give us a little bit more details on these two orders and also about potential returns.

Kenneth Hvid: Yeah. As you know, we have a very significant offering in the North Sea for our shuttle tanker business and we have a mix of both Suezmax and Aframax tankers operating there already. So, we always look at – we have a number of fields where we take smaller parcels, especially on the UK side and where we need some good workhorses.

So, essentially, it's the same technology as we're using on the Suezmax, i.e., they are LNG fuelled, which we're obviously very excited about because that's the most effective way to address the IMO 2020, which was a topic of much discussion on the previous call that we had with Teekay Tankers.

So, we are excited to be in a segment here where we can really order the ideal engine configuration with LNG as a fuel. The reason for that is that we are guaranteed the lifting points because we know these will be trading around the North Sea. The actual size of it is really just how we're optimising our lifting programme, where we have contract of affreightments that run for a number of years and we just look at that programme and configure the fleet accordingly.

Fotis Giannakoulis: And regarding – how does this compare versus the Suezmax's?

Vince Lok: They're quite similar. They might be – it's a little bit cheaper just given the size but overall, they're quite similar in terms of cost.

Fotis Giannakoulis: Thank you. One last question about all these three FPSO assets that you have at the parent level. Has there been any discussion with Brookfield about the potential sale of these assets to Teekay Offshore?

Vince Lok: Yes. There is an omnibus agreement in place, as you know, Fotis, where we're required to offer these assets for – if we decide to sell them, we need to offer these to TOO first. So, there is that omnibus agreement in place. So, if there's a – if we do have other interested buyers, we do need to give TOO that option to look at it.

Fotis Giannakoulis: I understand, but I was wondering if you have entertained any conversations about that given that the environment, the oil environment, is much more favourable than what it was a few months ago.

Kenneth Hvid: Yeah. I think these assets – some of them are a little bit shorter term in nature. I think some of the – it's three assets, right? Some of them fit well into – maybe one of them fit better into the TOO portfolio and the other two maybe less so. So, I would say we're likely to find other buyers for these assets based on the indications we're receiving from TOO. But at the same time, it's a dynamic environment and again, the situation looks very different today than it did a year ago. So, let's see how things unfold over the next quarter.

Fotis Giannakoulis: Thank you. I appreciate.

Kenneth Hvid: Thanks, Fotis.

Operator: And that does conclude our question-and-answer session for today. And I'd like to turn the conference back over to Mr Kenneth Hvid for closing remarks.

Kenneth Hvid: I'd like to thank you all for listening in to all our four calls today. And as you've heard, we've had another busy quarter across the group as we continue to execute on our financings, our vessel deliveries and continue to have very strong and safe operations. I'm pleased with the progress that we're making in all our companies and look forward to reporting back to you next quarter. Thank you.

Operator: That does conclude our conference for today. Thank you for your participation.