TEEKAY TANKERS LTD.'S SECOND QUARTER 2018 EARNINGS RESULTS CONFERENCE CALL

Company: **Teekay Tankers Ltd.**

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

Conference Time: **14:00 ET**

Operator: Welcome to the Teekay Tankers Ltd's Second Quarter 2018 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 your 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 Ltd's Chief Executive Officer. Please go ahead, sir.

Lee Edwards: Before Kevin begins, I'd like to direct all participants to our website at www.teekaytankers.com, where you will find a copy of the second quarter 2018's 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 second quarter 2018 earnings release and earnings presentation available on our website.

I will 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' second quarter 2018 earnings conference call.

With me here in Vancouver I have Stewart Andrade, Teekay Tankers' CFO, and Christian Waldegrave, Director of Research at Teekay Tankers.

Beginning with our recent highlights on **Slide 3** of the presentation:

- Teekay Tankers generated total cash flow from vessel operations of $16.6 million during the quarter, compared to $22.3 million in the previous quarter.
- We reported an adjusted net loss of $28.7 million, or 11 cents per share, in the second quarter of 2018, compared to an adjusted net loss of $22 million, or 8 cents per share, in the previous quarter.
- Crude tanker spot rates decreased in the second quarter, as OPEC supply cuts, a further drawdown of global inventories and an oversupply of tonnage continued to weigh on the market, which I will touch on in more detail later in the presentation.
- In June and July, we signed term sheets for two new financings, which, including our sale-leaseback transaction previously announced, are expected to increase our net liquidity position by approximately $110 million once they are completed.
- Finally, last week we secured a 12-month time charter-out contract, with an extension option, for one of our Suezmax tankers with a key customer. The time charter rate is well above current spot market rates and is expected to provide total fixed-rate revenues of $6.4 million over the initial 12-month period.

Turning to **slide 4**, since reporting earnings last quarter, we have continued to pursue various initiatives to improve our liquidity position during this period of weak tanker rates. Upon completion, our current financing initiatives will bolster our liquidity position by approximately $110 million, while also extending our debt maturity profile.

- In June 2018, we signed a term sheet for a sale-leaseback financing transaction relating to six Aframax tankers, which is in addition to the term sheet that we signed for a sale-leaseback transaction for 7 mid-size tankers that we previously announced. Both of these transactions are expected to increase our liquidity position, extend our debt maturity profile and include attractive purchase options for all 13 vessels. Please see the appendix to this presentation for our updated pro-forma debt maturity profile to reflect these transactions.

- In July 2018, we signed a term sheet for a loan, to finance working capital in our RSA pool management operations, which is also expected to increase our liquidity position.
- All of these financings are currently in the documentation stage and remain subject to customary closing conditions precedent and the execution of definitive documentation. We are targeting to complete them in the third quarter of 2018.
- On a pro-forma basis for the completion of these financings, our total liquidity position would be approximately $190 million as of June 30, 2018.
- We will continue to monitor our liquidity position and should the tanker market remain under pressure, we have additional options available to us which will further add to our liquidity position, including more sale leasebacks and select asset sales.

Turning to **slide 5** we look at recent developments in the spot tanker market.

OPEC supply cuts continued to weigh on crude tanker rates during the second quarter of 2018. OPEC crude oil production fell to 31.6 million barrels per day in April, the lowest level in over three years. The decline in OPEC supply was due to both high compliance with these production cuts and plummeting output from Venezuela, where supply is at the lowest level since the early 1950s.

The second quarter also saw a further decline in global oil inventories, with stockpiles in the OECD falling below the five-year average for the first time since 2014. This shows that global oil supply continues to lag demand, with oil being removed from inventories in order to meet the shortfall. This has acted as a drag on tanker demand over the past 18 months, as removing oil from inventories effectively replaces import demand.

However, in recent weeks, we have seen the return of some volatility to mid-size tanker rates, as shown by the chart on the right. This is particularly evident in the Atlantic Basin, with Aframax rates in the Mediterranean and UKCont exceeding $20,000 / day at times. We believe that increasing oil production from Russia and Saudi Arabia, coupled with rising exports from the US, are driving this volatility, which is encouraging as the third quarter is usually the weakest period of the year for tanker rates.

Turning to **slide 6,** we look at tanker market fundamentals, which continue to indicate a positive inflection point later in 2018.

Global oil demand continues to grow at a robust rate, with the major forecasting agencies projecting 1.6 million barrels per day growth in 2018 and a further 1.5 million barrels per day growth next year. As mentioned on the previous slide, high oil demand growth and OPEC supply cuts have led to a drawdown in global oil inventories below the five-year average and supported oil prices above $70 per barrel. This has led to a response from OPEC, who have pledged to increase oil production by up to one million barrels per day to keep markets well-supplied. We are already seeing this extra oil on the market, with Saudi Arabia and Russia reportedly adding 0.5 million barrels per day of production between them in June.

US crude oil exports continue to hit new highs, averaging more than 2 million barrels per day in recent months and reaching as high as 3 million barrels per day in some weeks. Approximately one third of US exports are flowing long-haul to Asia, with China being the second largest buyer of US crude this year after Canada. These flows may be threatened by the recent US / China trade dispute, though this could result in more US crude flowing to Europe directly on Aframaxes and Suezmaxes, which would add to mid-size tanker demand in the Atlantic.

Finally, we see the new IMO regulations on sulphur content in bunker fuels, due to enter into force in January 2020, as another positive development for the tanker market. Some of the positive impacts of the new regulations include:

- Increased refinery throughput in order to meet demand for low sulphur fuels, which should give a boost to crude tanker trade.
- Growth in clean tanker trade, due to the need to deliver these low sulphur fuels to global bunker markets.
- And finally, an increase in floating storage, particularly for excess high sulphur fuel oil which will have a reduced outlet market post-2020. We could also see the emergence of a new contango play over the next 18 months, which could further stimulate floating storage demand and tighten available fleet supply.

Turning to supply, the first half of this year has seen 15 million deadweight tons of tankers removed from the global fleet, putting 2018 on track for a record tanker scrapping year. In the mid-size segments, 41 vessels have been scrapped year-to-date versus 53 deliveries, equating to net growth of approximately 0.8 percent through the first half of the year.

Encouragingly, only 19 mid-size tanker orders have been placed so far this year, and with newbuild prices rising, we are hopeful that ordering will remain low. Looking ahead, we forecast that the mid-size tanker fleet will grow at a rate of just 2% per annum this year and next.

In sum, we continue to be encouraged by developments in mid-sized tanker supply and demand fundamentals and believe that an inflection point will be reached later this year. In addition, we believe that the new IMO regulations will be a positive development for the tanker market as we move towards 2020.

Turning to **slide 7,** as I touched on earlier, we have seen greater rate volatility in what is normally the weakest quarter of the year. This is reflected already in higher spot tanker rates for the third quarter of 2018 to-date, compared to the second quarter.

Based on approximately 39% and 37% of spot revenue days booked, Teekay Tankers' third quarter to-date Suezmax and Aframax bookings, have averaged approximately $14,200 and $14,000 per day, respectively.

- For our LR2 segment, with approximately 31% of spot revenue days booked, third quarter to-date bookings have averaged approximately $10,700 per day.

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

Operator: Thank you. The question and answer session will be conducted electronically. If you'd like to ask a question, please do so by pressing the star key followed by the digit one on your touchtone telephone. If you're using a speakerphone, please be sure your mute function is turned off to allow your signal to reach our equipment. Once again, press star one to ask a question. And we'll take our first question from John Chappell with Evercore.

Jon Chappell: Thank you. Good morning, Kevin.

Kevin Mackay: Morning, Jon.

John Chappell: First question, or two, on the new sale-leasebacks that you just announced. So, $190 million certainly seems like a long runway for a company of your size, but obviously you're not the first to do these, and you probably won't be the last. I'm just curious, 13 ships, $190 million of total pro-forma liquidity, is that a good place for you right now as you see kind of the current market, or are there still opportunities in the sale-leaseback market that you're pursuing?

Kevin Mackay: A good question, Jon. It's something that we've been really pleased in terms of our progress that we've managed to make over the last couple of quarters, to raise our liquidity level to that amount once we close these. Based on our projections for the market and where we think the volatility will come back, we're pretty confident that this should be enough to see us well through the rest of the headwinds that we'll probably face in the market, and see us through to the other side. But we do have a plan if those don't work out, and we, in our projections, look at worst case scenarios. And as I mentioned in the highlights, we do have other options on further sale-leasebacks or potential assets sales. So at this point in time, seeing the volatility start to come back into the market and raising the amount that we have, I think we're feeling a lot more comfortable than we were at the start of the year.

Jon Chappell: Okay. And then I don't think we had full disclosure on the first sale-leaseback, and I think they're both closing in the next eight weeks or so. Were the terms of this most recent sale leaseback similar to the terms of the first sale-leaseback, and were the counterparties similar as well?

Stewart Andrade: Hi Jon, Stewart here. Actually the – it is a different counterparty, so it isn't the same counterparty. We're in documentation on both, as Kevin mentioned, and the terms are actually quite different between the two sale-leasebacks, both the advance ratio and the borrowing cost. But in aggregate, as Kevin said, between the two sale-leasebacks, it’s $90 million of liquidity that it will add, and the average bareboat rate across the two is about $8,200.

Jon Chappell: Okay, $8,200. And then does that – can we back into the implied fixed cost associated with that, or is that something you could [inaudible] on?

Stewart Andrade: I'm sorry, you cut out, I didn't quite hear you.

John Chappell: Can we, kind of, back into the implied fixed [inaudible] associated with $8,200 [inaudible], or is that something that you can provide for the – each of the transactions?

Stewart Andrade: I'm sorry, I didn't actually – we're having a problem with the line and I didn't catch that. Are you asking for the borrowing cost? Is that what you're asking?

John Chappell: Exactly, yeah.

Stewart Andrade: The borrowing cost is, it ranges on them between in the sort of low to mid-sixes up to then sort of mid-eights.

John Chappell: Okay. I'll wait for the final documentation. And really just quick, Kevin, you've talked a lot the volatility, but obviously liquidity is of the utmost importance, so I wouldn't think [inaudible] would be acquiring ships at the bottom of the market. But do you think you'll be more aggressive in the [inaudible] market, given the kind of near-term optimism you have?

Kevin Mackay: Again, apologies, the line's breaking up. So, if I don't give this answer tied to your question properly, John, go ahead and ask it again. But, no, I think we've got a fleet of close to 60 tankers in a space that I think is going to be pretty exciting as we get closer to 2020. So, I think we have enough exposure to the market. When things start to turn and improve, it should really start to impact our bottom line well.

So, at this point, taking on additional risk by adding tonnage is not something that I feel that we need to do, but it certainly something that we look at ongoing. And if there's an opportunity there where we see some low-hanging fruit and we can position a vessel into a market or a region that we think is going to have increased volatility, it's definitely something that we will continue to look at. So, I wouldn't rule it out. But again, it's not something that we need to go out and take on far more additional risk until we actually see the volatility on a consistent basis, month after month.

John Chappell: Right. Okay, that makes sense. Thanks Kevin. Thanks Stewart.

Stewart Andrade: Thanks, John.

Operator: And next we'll move to Noah Parquette with JP Morgan.

Noah Parquette: I wanted to get your guys [inaudible] the rate of ordering, you know, relatively high, more on the VLCCs, but kind of slowed down lately. Can you talk a little bit about why you think that is happening, and are you concerned at all about the new supply coming online?

Kevin Mackay: Okay. Thanks, Noah. Yeah, it's a good question. I think it's something that's grabbed the headlines with speculative ordering on the VLCC side in advance of the IMO regulations kicking in. I'm more focussed on the mid-size space, and I think, the ordering, as I've mentioned, we've only had, I think, it was 19 orders reported this year across the whole mid-size segment, which is really positive. And I think with new building prices continuing to inch up, we're hoping that that will be a deterrent to people coming in and speculating in the mid-size space.

But overall, I think the fleet growth numbers across the whole tanker space, although there has been ordering, it still remains below the average five-year – sorry, the 5% growth rate that we've definitely seen historically. So, at this point in time, I'm keeping an eye on it, but I'm not wholly concerned.

Noah Parquette: Okay. And then just following up on the details around [inaudible], did I hear that right, you said $90 million [inaudible] two sale-leasebacks, and I guess would that imply the working capital [inaudible]?

Kevin Mackay: Yeah, that's correct.

Noah Parquette: Okay. Thanks, that's all I have.

Kevin Mackay: Thanks, Noah.

Operator: And next from Merrill Lynch, we'll go Ken Hoekster.

Ken Hoekster: Hey good afternoon, it's Ken Hoekster. I just want to follow up, you were chopping in and out, just like you said, some of the questions were before [inaudible] before. So, I just want to understand your thoughts on tanker [inaudible]. Are you suggesting the trough is behind, just given what we're talking about on capacity, or are you [inaudible] rates or are you seeing them continuing to struggle?

Kevin Mackay: Well, we have to be honest, the rates aren't fantastic. But where we are encouraged, is that we're sitting here in August, and we're looking at markets such as the US Gulf starting to pick up, the Med in the mid-to-high teens and relatively supported. There's increased volatility in Asia. So generally, for a typical third quarter, we're encouraged by the fact that the market is able to move up and down in various markets. Which, to us, speaks to a tightening of the supply-demand balance in various areas, which tend to pertain to the fundamentals starting to swing in our favour. Do I think that we're there yet? Do I think that month on month things are going to improve? We can't say that, it's a volatile market. But I think comparing the last couple of months with what we've seen over the last six, seven, eight months, we're encouraged by some of the volatility that we're seeing.

Ken Hoekster: And just on, you know, I know you've [inaudible] to John's questions before, kind of, very concerned about the capital and the runway there. But how do you think about [inaudible] in terms of affecting [inaudible]. How do you plan to comply with ballast regulations?

Kevin Mackay: You broke up there, so again apologies if I don't get the answer correctly directed to your question. But we, in our forecasting methodology, do look at where we think our exposure is in terms of having to put ballast water treatments systems on ships, and that is built into our forecast models. But at this point in time, with the liquidity initiatives that we've got in place, we feel more than comfortable that we can handle whatever implementations of that equipment that we might have to put in in 2019 or 2020.

Ken Hoekster: And same for IMO 2020 too?

Kevin Mackay: For IMO 2020 there is actually no capital cost component if you don't install scrubbers. And at this point in time, Teekay Tankers doesn't have plans to put scrubbers on our tonnage. So from a CAPEX requirement, it's not something that we've had to build in.

Ken Hoekster: Okay. And then I might have missed your answer to part of Noah's question, if I could just follow-up on that. Your concern the – I think he was asking about rate of order load, but I guess there's – if there not a slight uptick in delivery 2019 versus 2018. Are you concerned [inaudible] more vessel capacity coming online?

Kevin Mackay: Probably, Christian, you could probably give some facts.

Christian Waldegrave: Yeah.I think, as you've touched on, the growth that's coming next year is really concentrated in the VLCC segment. So in the rest of the tanker fleet, we're probably looking at less than 2% growth in 2019. In the Vs that you've touched on, because of the ordering, it is a bit higher, it's probably going to be in the region of 4-5% growth on the Vs next year. But when you net it all out, we're looking at fleet growth – total tanker fleet growth next year of about 3-4%. Which is obviously up a little bit from this year, but it is below average levels. If you look at the last decade, the tanker fleet grows by an average 4-5%, so it's still not [inaudible] the normal levels of fleet growth.

Ken Hoekster: I'm sorry, Christian, you said that the net growth of what? Did you say 3-4%?

Christian Waldegrave: 3-4% across the whole tanker fleet. Which isn't abnormally high levels of fleet growth compared to what we've seen over the past decade. So even though the Vs are a bit higher, I think when you net it out with the lower growth in the mid-size, we're not too worried about the fleet growth next year.

Ken Hoekster: Okay, great. Thanks for the time.

Christian Waldegrave: Thanks, Ken.

Operator: And next we'll go to Amit Mehotra with Deutche Bank.

Chris Schneider: Hi. This is Chris Schneider on for Amit. First question is around IMO 2020. I know you guys said you think it's positive for the tanker market, and I think everyone agrees it's positive on the product side. I think the outlook on the crude side is a little more thin[?], you know, there's clearly positives with new trade lanes, potential for storage demand and slow steam. But you're also, on the crude side, losing on the bunkering trade. If you could just provide any colour on how you think all of that nets out with a specific focus on the crude tanker fleet?

Kevin Mackay: It's a good question, and it's something that there's a lot of question marks around how IMO and the implementation of the regulation is going to fundamentally change a lot of different aspects of oil flows. I think, Christian, you can probably confirm this, but I've seen projections where the increase in crude demand is roughly 1.5 million barrels a day of additional crude that will need to flow in order for refineries to generate enough low-sulphur fuel to supply the market. So, I think there will be incremental demand on crude just to meet the fuel supply requirement.

But, I think the more interesting aspect is what we're going to see in the change in trade patterns. And interestingly enough, we're starting to see that already. Just last week, we had a customer enquire about providing a contract of a affreightment on our Aframax business to move low-sulphur crude into a refinery which traditionally has used heavy [inaudible]. So I think the refiners are already starting to look at their crude slates, and as a result we're going to start seeing more and more of these questions and experiments on moving different grades of crudes from different regions than what we've historically seen. And typically, when you get dislocations like that, you get inefficiencies in the system, which eats into supply of tonnage and increases tanker demand.

So, although I would agree with you that on a per barrel basis where it looks to today, it looks like the clean trade will benefit in terms of greater volume. I think the interesting piece of the crude space is in the change in crude flows and the inefficiency that's going to create.

Chris Schneider: Thank you for that, it's very helpful. And the next is kind of around the contracting environment. With Suezmax and Aframax rates picking up over the past few weeks, have you seen any increasing flows from charters looking to lock-up tonnage maybe longer term or [inaudible] some long-term time-charters?

Kevin Mackay: Yeah. I think the oil companies and the traders are looking at the same fundamentals that we're looking at, and are starting to come into the market, certainly more so in the last two months than what we've seen in the last 12-18 months. The level of enquiries has picked up, they're looking for cover certainly through the 2020 period. And one of the reasons that we were able to secure the time-charter on the Suezmax we did, was because of the relationship we have with one of our key customers, where in the last again 6-18 months we haven't seen that level of enquiry.

Chris Schneider: Following up on that, if you are seeing an increase for maybe two, three-year charters, are those coming in [inaudible] one-year rates that we're seeing being published?

Kevin Mackay: Well, other than the deal we've done, I haven't seen any specific figures on what other people have been able to conclude. But across the market indexes, certainly we were very happy with what we were able to achieve above that level.

Chris Schneider: Okay. That does it for the time, guys. I appreciate it.

Kevin Mackay: Thanks, Chris.

Operator: Alright. And next we'll go to Magnus Fyhr of Seaport Global.

Magnus Fyhr: Good afternoon. I have one question on the IMO 2020. You mentioned the transportation of clean products are likely to increase significantly beyond 2020. Can you refresh my memory, how many of your nine LR2s are currently trading clean?

Kevin Mackay: At the moment, we have, I think it's three.

Magnus Fyhr: Okay. And are there any thoughts about how long will it take to get those ready if you want to change them from dirty to clean and what would the expected cost be?

Kevin Mackay: It's a very difficult question to answer, Magnus, because there's a lot of moving variables when you come into try and get the ships cleaned up. A lot depends on the availability of the right types of cargo in the region that your ship is in and where you position the ship to. Often times you have to carry, sort of, what we call 'lag cargoes' until you can get the next condensator to clean up. So it can vary from a couple of months to six months, it all depends how active the clean market is, and where you're positioning your ship into. And again, in terms of cost, it all comes down to what kind of grades you're putting on the ship and what kind of residual cleanage and cleaning that leaves you having to do with chemicals and other agents. So I can't [inaudible] a fixed number [inaudible] to run a number off.

Magnus Fyhr: Is it too early or do you have internal discussions whether you position those vessels in the clean trade ahead of time[?], or would you wait to see how the market develops?

Kevin Mackay: We have LR2s because of their fungibility between the crude and the clean trade. And at the moment, the signals that we're getting is that the volatility is returning quicker to the crude space than it is to the clean market. So for the time being, we're watching and waiting. We did transition over a couple of ships earlier this year, and we've held off doing any more until we see stronger signals on the [inaudible] side that we're able to get their ships cleaned up. So for now, they're going to stay in the crude trade.

Magnus Fyhr: Alright. Very good, thank you.

Kevin Mackay: Thanks, Magnus.

Operator: And next we'll go to Fotis Giannakoulis with Morgan Stanley.

Fotis Giannakoulis: Hi guys, only a modelling question. If you can give any guidance about the ballast water treatment cost, the CAPEX that you have for the next few years?

Stewart Andrade: Hi Fotis. So for – we're still working through exactly which vessels we'll have to fit the ballast water treatment systems on in 2019. But I would say as a maximum, we're looking at about $20 million in 2019, and I think there's a good chance that we won't end up having to fit all of those. And in 2020, about $20 million in 2020 as well.

Fotis Giannakoulis: Okay, guys. Thank you so much.

Stewart Andrade: You're welcome.

Operator: And that concludes today's question and answer session. I would like to turn the call back over to Kevin Mackay for any additional comments or closing remarks.

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

Operator: And that does conclude today's conference. We thank you for your participation, you may now disconnect.