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

Company: **Teekay Tankers LTD**

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Conference Time: **13:00 ET**

Operator: Good day. Welcome to the Teekay Tankers Limited, First Quarter 218 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 the question. For assistance during the call, please press star zero in your touchtone phone. As a reminder, this call is being recorded. Now for opening remarks of introduction, I'd like to turn the call over to Kevin Mackay, Teekay Tankers Limited'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'll find a copy of the first quarter 2018 earnings presentation. Kevin will review this presentation during today's conference call. Please allow me to remind you that our discussion today contains forward-looking statements. Actual results may differ materially from results projected by those forward-looking statements. Additional information concerning factors that could cause actual results to materially differ from those in the forward-looking statements is contained in the first quarter 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 First Quarter 2018 Earnings Conference Call. With me here in Vancouver, I have Stewart Andrade,

Teekay Tankers' Chief Financial Officer and Christian Waldegrave, Head of Strategic Research at Teekay Corporation.

Beginning with our recent highlights on slide three of our presentation, Teekay Tankers generated total cash flow from vessel operations of $22.3 million during the quarter compared to $32.1 million in the previous quarter. We reported an adjusted net loss of $22 million or $0.08 per share in the first quarter of 2018 compared to an adjusted net loss of $5.9 million or $0.03 per share in the previous quarter. Crude tanker spot rate decreased in the first quarter of the year as OPEC supply cuts and an oversupply of tonnage continued to weigh on the market which I will touch on in more detail later in the presentation.

In April 2018, we signed a term sheet for a seven-vessel sale lease back financing which upon completion is expected to provide approximately $36 million in addition liquidity while also extending our debt maturity profile. I will discuss this transaction in more detail on the next slide. While tanker rates remain at cyclically low levels, our full-service lightering business helped mitigate some of the impact as our combined Aframax spot TCE rates were $15,100 per day which were significantly above market average rates.

Turning to slide four, I will highlight important steps we are taking to further strengthen our balance sheet and liquidity position during this period of weaker tanker rates. In April 2018, Teekay Tankers signed a term sheet for a sale lease back financing transaction relating to seven modern tankers including three Suezmaxes, two Aframaxes and two LR2 product tankers. The transaction is structured as ten to 12 year bareboat charters at an average rate of approximately $7200 per day with attractive purchase options after year three for all seven vessels. When completed, the transaction will bolster the company's liquidity position by approximately $36 million and provide funds to refinance our only remaining 2018 debt maturity.

Our debt maturity profile including the impact of the sale lease back transaction can be found in the appendix to this presentation. As communicated last quarter, the continued market weakness and challenging outlook has led us to re-evaluate our minimum quarterly dividend. In order to further bolster

our liquidity position during this cyclical downturn, we have made the decision to eliminate our minimum quarterly dividend of $0.03 per share. We believe this is a prudent decision until the tanker market recovers, will provide Teekay Tankers with approximately $32 million of addition liquidity on annualized basis.

It's important to note the earnings linked variable portion of our dividend policy remains unchanged providing investors with direct participation in a tanker market recovery. We'll continue to monitor our liquidity position and should the tanker market remain under pressure, we have other options available to us which will further strengthen our balance sheet including further sale-leasebacks which are currently under discussion, select asset sales and obtaining financing of our services business.

Turning to slide five, we look at recent developments in the tanker spot market. OPEC supply cuts and an oversupply of tonnage continue to weigh on tanker rates during the first quarter of 2018. A very weak VLCC market due to supply constraints in the Middle East OPEC countries and declining output from Venezuela have put downward pressure on tanker markets. This has impacted the midsized tanker segments as VLCCs have been forced into the Atlantic Basin to compete with Suezmaxes for West African cargos while reduced Venezuelan export to the US has impacted Aframax demand in the Caribbean.

Rates were further affected by seasonal refinery maintenance during the first quarter with global refinery throughput hitting a low of approximately 18 million barrels per day during March of this year versus 82 million barrels per day at the start of the quarter. One highlight has been our Aframax spot earnings during the quarter which at $15,000 per day was approximately $4,000 to $5,000 per day higher than our peers and industry benchmarks. This is due to the contribution made by our full service-lightering segment which enjoyed strong earnings in the first quarter resulting in stronger overall Aframax spot earnings.

Turning to slide six, we look at tanker supply fundamentals. A significant positive development in the tanker market since the start of the year has been scrapping. Just over eight million dead weight tons of tankers were scrapped in the first quarter of 2018 which is the highest level of scrapping seen in any quarter since 1982

as shown by the chart on the left. More than 50% of the vessel scrapped this year have been less than 20 years of age which is a sign that low freight rates, high scrap prices and the potential impact of upcoming regulations are leading tanker owners to scrap vessels at a younger age than in the past.

Scrapping has continued in the early part of this quarter increasing the year to date level of scrapping to 11 million dead weight tons. This is roughly equal to the amount of scrapping seen in the whole of 2017. This high level of tanker scrapping is helping to offset new vessel deliveries and is leading to lower growth in the midsized tanker fleet as shown by the chart on the right. Peak fleet growth in the midsized fleet occurred in 2016 at approximately 5%. This growth rate is set to fall steadily to around 2% growth by 2019. Furthermore, we expect fleet growth to remain relatively low in 2020 based on the current order book and expected vessel scrapping.

While there is still potential for further vessels to be ordered for delivery in 2020, we expect that a combination of increasing new build prices, reduced shipyard capacity and a drive by the shipyards to target more complex vessels such as LNG carriers and large container ships will keep orders from midsized vessels within manageable levels.

Turning to slide seven, we look at developments for the tanker demand side. Global oil demand remains robust with major forecasting agencies projecting growth of 1.6 million barrels per day in 2018. This is an increase of around 200,000 barrels per day compared to their initial 2018 forecast made last summer. We are encouraged by this continued trend in oil demand and believe it will be a key factor in driving a tanker market recovery. Chart on the right of the slide shows oil market balances through the end of the year based on the latest projections of oil demand versus supply.

The chart shows the OECD oil inventories when measured by days of forward cover have fallen from 66 days in Q2-2016 to less than 60 days as of Q1-2018. This has coincided with an increase in oil prices from around $35 per barrel at the start of 2016 to a current price of around $80 per barrel. Forward cover is expected to decline further in the second half of the year which should further support oil prices in the coming

months. By the end of the year, we estimate the OECD oil inventories could fall to approximately 56 to 57 days of forward cover. The last time inventories dropped to such levels, oil prices rose above $100 a barrel.

We believe that further tightening of oil markets in the second half of 2018 will drive firm oil prices and that this will incentivize OPEC to increase production towards the end of the year. With both Iran and Venezuela facing potentially lower production volumes in the coming months, this adjustment by OPEC could come even sooner than expected. An increase in OPEC production volumes which are generally long haul in nature would give a lift to tanker demand in the next few months coinciding with a period of low fleet growth as outlined in the previous slide. In summary, we believe the fundamentals point towards a tanker market inflection point in late 2018 or early 2019 leading to an improvement in rates versus today's cyclically low levels.

Turning to slide eight, I'll provide an update on spot tanker rates in the second quarter of 2018 to date. Based on approximately 56% and 52% as spot revenue days booked, Teekay Tankers second quarter to date, Suezmax and Aframax bookings have averaged approximately $11,100 per day and $12,800 per day respectively. For LR2 segment with approximately 50% as spot revenue days booked, second quarter to date bookings have averaged approximately $10,600 per day. With that operator, we're now available to take questions.

Operator: Certainly. And again for the phone audience, that is star one if you'd like to ask a question. If you're using a speakerphone, please make sure your mute function is turned off t allow your signal to reach our equipment. Again, press star one to ask a question. And we'll take our first question from Jon Chappell with Evercore.

Jon Chappell: Thank you. Good morning, Kevin.

Kevin Mackay: Good morning, Jon.

Jon Chappell: Couple of questions on your recent transactions if you can answer them. First, I was just wondering if you can identify which ships were involved in the sale lease-back and I ask this not just because it would be helpful for us to model it, but also as we think about the purchase options, I know as I think it would be important to know what the useful life of the ship would be after you can potentially buy them back in three years and then also as we think about other options for you to kind of understand if other sale lease-backs or other straight vessel sales would be kind of your older tonnage or your newer tonnage.

Kevin Mackay: Great. I think as I said in my prepared comments, it was a mixture of two Aframaxes, two LR2s and three Suezmaxes. I think sure, we can provide the names of those specific ships offline if anybody is interested in working through the calculations you're specifically referring to.

Jon Chappell: Okay, that would be helpful. And then the other one I want to ask about to you is – so, the charter ins – you know, they're pretty short term in nature and you just laid out an industry backdrop where it remains challenging for now and hopefully an inflection point in the back half of this year. But it seems like the charter ins – and I understand the one for the lightering business. So, maybe just the other one doesn’t benefit from that unless the options exercise. So, in a market where there’s cash burn on existing assets, what was the reasoning for taking more ships on charter-in right now?

Kevin Mackay: Fundamentally, even though the market remains low, given our scale in both the Atlantic and the Pacific their skill opportunities for us to triangulate around our COA base and the in-charter rates on this ship is about $10,000 a day. So, as you look at the spot market, the earnings, they don’t give you the clear picture of where we’re able to make the extra margin when we do those triangulations in and around the Pacific for example. And we incurred the demurrage at ports – there is still congestion. So, on an absolute return basis, we felt the $10,000 a day, it was worth the trading opportunity to still take in the ship and make a margin off of it. And so far what we’ve seen since we took the ship in the beginning of March is she’s returning well.

Jon Chappell: Okay. And then finally, you know, you mentioned also in your prepared remarks that there's some other sale-leasebacks under consideration. You've increased liquidity between the dividend and the first seven sale-leasebacks by almost $70 million. How do you kind of feel today about the liquidity situation as it leads up against your market forecast and should we expect to see more of these transactions executed by the next time you report?

Kevin Mackay: Yeah, I think it's a good question. It's something that we are monitoring constantly and engaged with the board in terms of what our forward actions that we take and which levers we pull, at this point in time given the transaction we've undertaken and the cutting of the minimum dividend, we feel fairly comfortable looking forward based on our forecast of what the rates will look like. But it's the tanker market and it's cyclical and unpredictable. And as such, it's prudent for us to look at the potential for the market to not be as good as what we forecasted and line up potential transactions that would help bolster our balance sheet. So, as I said it's something we continue to monitor. And as we talk to the board, it's something that we have to demonstrate to them, not just what our forecast is, but both the high case and a low case of what could happen going forward and be prepared for that.

Jon Chappell: Okay. All right, appreciate the answers Kevin. Thank you.

Kevin Mackay: Thanks Jon.

Operator: Moving on, we'll take our next question from Amit Mehrotra from Deutsche Bank.

Chris Snyder: Hi, this is Chris Snyder on for Amit.

Kevin Mackay: Hey, Chris.

Chris Snyder: So, in the release you guys noted you had several options available to strengthen the balance sheet further. Should we expect that this just means additional sale-leasebacks or would you guys kind of consider selling some of the older tankers in the fleet, you know, as we've kind of seen the bid here for residual values or they're just additional leverage you could pull any call on that would be really appreciated.

Kevin Mackay: Yeah, I think every lever has different opportunities and benefits to our balance sheet. It's really a question of where we see the forward market. The sale-leaseback transaction do give us attractive purchase options that when the tanker market recovers and our balance sheet is stronger, allows us to recapture our own scale. In terms of the asset sales outright, once you sell an asset outright, it's gone and there is no upside. So, I think we look to the different levers having different impacts, then – you know, factor in our decision making based on what those impacts are and what our full review is and what we need to do.

Chris Snyder: Thank you for that. And when you guys kind of look at the older – the 2003-2004 built tankers and the fleet, if you were to dispose of them would you expect that they would just head to the scrap yard or do you think there would be buyers for those assets that would want to operate them?

Kevin Mackay: I think it's mixed. As we mentioned in our remarks, the scrapping – the average age of the scrapping is actually below 20 years. So, we are seeing owners with vessels at the end of their life cycle heading to scrap as opposed to selling forward. In the second hand market, there's definitely pressure on older ships in terms of pricing. So, the relative benefit of selling onward versus scrapping is definitely leaning towards the scrap market. But I think any transaction on an asset is looked at wholistically and to see what benefit there is and what price upside we can obtain.

Chris Snyder: Okay, that makes sense. And then next, we've been reading a lot about potential capacity constraints at the scrap yards. Can you provide any colour on what you're seeing here and if this could become a potential headwind to the strong pace of scrapping that we've seen year to date?

Kevin Mackay: Christian, you want to take that?

Christian Waldegrave: Yeah. I think with regard to capacity of those scrap yards, that's not so much of an issue and certainly at the moment, you've got India and Bangladesh, the talk of Pakistan coming back into the market as well which would alleviate some of the pressure and offer more capacity. What we've seen this year is that scrapping was pretty strong through Q1 as Kevin said about eight million dead weight. It has slowed down a bit, but certainly, we're still seeing pretty regular sales of ships going for scrap. So, I think it's going to be more of function how the freight market operates through the summer versus the scrap price on offer that – as opposed to the capacity. I don't think capacity is going to be a major issue for the rest of this year.

Chris Snyder: Okay, yeah. Makes sense. And then just quickly following up on that, so far, you know, the high majority of the scrapping has been on the VLCC side, not quite as much on the Suezmaxes and the Aframaxes. And I was kind of wondering what you guys think is driving this. Is this just that – the smaller segment? The rates have obviously been a little bit more resilient or is it just the scrap yards kind of have their pick and you know you want the biggest vessels with the most scale?

Kevin Mackay: Well, I think I wouldn't necessarily agree that it's predominantly been VLCCs of scrap. There's been over 20 Aframaxes that have headed to the scrap yard and I think around eight Suezmaxes. So, I think it's – scraping is seen through all the segments as owners come up to decision making time around – dry docking cost and potential extensive CapEx costs around ballast water treatment systems and the potential for what happens in 2020. So, I think it's not just focused on the V market. It's focused across the fleets with every owner looking at the same decision parameters.

Chris Snyder: Okay, thank you for the colour. That does it for me and thanks for the time guys.

Kevin Mackay: Thanks Chris.

Operator: Moving on, we'll take our next question from Magnus Fyhr from Seaport Capital.

Magnus Fyhr: Yes, good afternoon. Just one question on the Aframaxes during the quarter. You mentioned that they were boosted by strong performance from the lightering business. Is this something that you see continue through second and third quarter or is this just a onetime event? And also if you can comment on the longer-term prospects for the lightering business given recent developments on increasing capacity for US exports?

Kevin Mackay: Yeah. Good question, Magnus. The performance on the Aframax fleet in terms of the volumes we're seeing for the US Gulf lighterage seems to be fairly steady. So, I would imagine that that fleet will still perform at a premium to what the average spot market does in the other markets around the world. In terms of the forward view on developments, there has been some news around loop and Corpus Christi, some terminal builds there. Certainly, I think there is investment going to take place to increase the flow of exports out of the US Gulf and obviously, it is cheaper to get those barrels on to larger ships.

But having said that, you have to bear in mind that 70% of our volume is still import-based. I think as a lot of people focus on the US export story, they're forgetting that there's a constant five million barrels a day that come in from long haul crudes that need to be lightered. So, I think the longer-term prospects for lighterage is steady to strong. But we are going to see development of bigger berth that allow certainly Suezmaxes and potentially down the road some VLCCs. But I think a lot of these projects at this point in time are still sourcing financing and some of the projected start-up dates may move around as we go forward based on their ability to get federal funding and such. It's certainly an interesting space for us to be in. And as you've seen, it's been very accretive to our performance.

Magnus Fyhr: Right. But if 70% of your business – or of the volume is import based, wouldn't that also be impacted by opening up some of these ports for exports, would they only be export terminals or would they be open for imports as well?

Kevin Mackay: Our understanding is the configurations in some of these pipelines is it's all looking at export base.

Magnus Fyhr: Okay.

Kevin Mackay: They're obviously looking for –

Magnus Fyhr: Very good, thanks for clarifying.

Kevin Mackay: Yeah.

Operator: Again, to ask a question, that is star one. Moving on, we'll take our next question from Fotis Giannakoulis from Morgan Stanley.

Fotis Giannakoulis: Yes. Hi guys; a little bit of a modelling question. Can you give us your guidance about dry dock expenses and what is going to be the ballast water expenditure that you're forecasting?

Stewart Andrade: Hi Fotis. In terms of ballast water, maybe starting there; obviously, nothing into 2018 for ballast water. And for 2019, we have approximately $18 million to $20 million which we have allocated or forecast for ballast water in 2019. However, we are looking at the trading patterns of those vessels and the equipment availalbity on those vessels and it may be that we don't need to fit ballast water on those. So, I would say the range is probably from zero, up to $18 million to $20 million depending upon how things go.

In terms of dry docking this year, we've got – if you look at Page 16 of the presentation, we have two vessels scheduled for Q2 and then another roughly eight for the – sorry, another ten of the remainder of the year. So, we're looking at 12 overall. And you know, seeming a couple of million dollars per dry dock is probably reasonable on those.

Fotis Giannakoulis: Okay, thank you very much. And you have – your Aframax rate that you reported, they have been well above the market. I was trying to understand is this due to triangulations that you did. How do you explain this outperformance and any COAs that you might have? And also, if you can give us a range of the earnings that you have – that your fleet has earned in each category that is based on the age of the vessels, how would you see – have the modern vessels got $2,000 or $3,000 more than the older vessels?

Kevin Mackay: I think to take your first – the last part of your question Fotis, we do do the analysis. We don't have it on hand. It's certainly something that we can take offline with you. But in terms of vessel age versus performance, there's a lot of factors that can come in on a quarter by quarter basis depending on where the ship ballasts in from what kind of voyage she's able to procure next. There isn't a direct on a quarter-by-quarter basis a direct correlation between agent and TCE.

In terms of your first question around Aframax performance, we highlight quite clearly in the presentation in my remarks that the boost through our earnings came from our US Gulf full service lighterage business. And that is based around contracts of affreightment as well as spot lighterings that do pay a premium for the special light service that we provide our customer base.

Fotis Giannakoulis: And can you remind us – can you give us an idea of what is the cost of reverse lightering right now on a dollars per barrel for a US exporter?

Kevin Mackay: You know, it varies Fotis, on what kind of ship we're using, where the lightering area is and what kind of volume the customer wants us to take out of the port. So, I can't give you a precise per barrel cost right now.

Fotis Giannakoulis: Is there a range or an estimate that you think that US exports will have to – average per barrel cost for US exports in addition to the freight cost from the US to Asia?

Kevin Mackay: Well, if you look at oil price spreads, you've got an $8 spread between WTI and Brent. So, your shipping components – long haul plus the lighterage has to – it has to be within that bad. So, I would, at a rough estimate depending on, again where you're loading and how many barrels you're putting on board, you're talking about $1 to $3 per barrel potentially.

Fotis Giannakoulis: That's very helpful. Thank you very much.

Kevin Mackay: Okay, thanks Fotis.

Operator: Moving on, we'll take our next question from Ken Hoexter from Merrill Lynch.

Ken Hoexter: Yeah, good afternoon. Just – you mentioned the shift of tonnage over to the Atlantic Basin. Is that something that is still going on and could continue to pressure rates is that shift done? Yeah, I guess I'll leave the first one there.

Kevin Mackay: Sorry, can you repeat the question again?

Ken Hoexter: Yeah, you mentioned at the beginning that the shift of tonnage – you've seen a big shift of tonnage over to the Atlantic basin of the VLCCs and that it put additional pressure on the Suezmax rates. I just want to know if that shift – if you're still seeing additional vessel shift over – putting even further pressure or have you seen that the transition of the vessels ease up a bit?

Kevin Mackay: No, I think it's been a fairly steady pace really since the backend of last year as the Middle East has cut production, we're seeing a lot of VLCCs just bypass the Middle East as a loading area and coming straight from Asia back to either West Africa or the Caribbean. So, it's not something that I think is spiked under the current environment, it's something that we've seen quite steadily over the last six to nine months. And again, that's purely a function of the lack of – or the cutting of barrels out of the Middle East.

There is very little volume moving AG West and with rates being below OPEX on AG east-bound runs, VLCC owners are doing their economics and seeing that West Africa to China and Caribs to China is a better run, albeit the low levels they are. So, that's where you're seeing the steady stream.

Ken Hoexter: And are there any more synergies to get out of international – the acquisition is that G&A can pull back or will that continue to climb? What are your thoughts on that?

Stewart Andrade: I think that the – obviously with the acquisition of TIL late last year, our ship count going up by 18, we have had some increases in G&A. This quarter's G&A was a little bit higher due to some equity comps that typically expensed in Q1. So, it was about $500,000 higher than I would say, run rate. So, run rate is more like in the – probably $9.1 to $9.3 range going forward and don't expect to see it to continue increasing.

Ken Hoexter: That's helpful, thank you. Next up just on the – one of the bigger picture question is if you don't mind, but could we be on a structural oil decline kind of market given the move to electrify the auto market, the truck market, I guess transportation in general? If that occurs, is that a thing that – a shift that you see that could slow or decelerate the oil demand relative to the amount of capacity that's hitting the water. Is that something that you think can affect that total?

Kevin Mackay: I think certainly longer-term; it's going to have an impact on oil demand sort of in the energy demand column. I think the fact that we have to bear in mind though is with both population growth and the increase of the middle class particularly in Asia, China and India, that energy demand column is going to be significantly higher. So, while oil may drop in terms of percentage against LNG or other forms of energy, it's still going to be a significantly large demand for oil. And I think certainly in the short to midterm, I don't think the electrification of either cars or trucks is going to have a material impact on oil demand or tanker demand.

Ken Hoexter: Yeah, I know, big picture question, but helpful to hear the answer. Thank you. You mentioned kind of increased confidence as we move later this year. What are your thoughts on the shift between spot and contract? Do you have kind of targets? I know when you first spun off Teekay Tankers; there was kind of always a target on what you wanted to look at on the spot versus contract. How do you think about that in this environment?

Kevin Mackay: Yeah, our hedging portfolio management is really something that we monitor constantly. And as you saw us do going into this cyclical downturn, we did see term cover and more contract cover to sort of bolster our earnings to try and get through this market headwind. Those contract covers as they come off then evaluate what our view is going forward both on a very short-term basis and on the longer sort of one to three-year basis and make adjustments there. I think given the fundamentals and where we think the market is heading, you won't see us take on three-year time charters at this point. But you may see us go into the market and put away tonnage for short duration six to twelve months as a hedge against potential uncertainties. But at the moment, if you include our lighterage contracts, they give us fixed rate cover, we're around 22% hedged against the spot market.

Ken Hoexter: That's helpful. And I'm sorry, if I could just get one follow up for Kevin. So, given that – what is your view on rates given what you mentioned before about the pace of scrapping, record scrapping? Do you think we've kind of hit a floor from your perspective in looking at the market or do you just see this kind of pressure remaining on rates at these levels for a certain amount of time? What are your thoughts on rates?

Kevin Mackay: As I said, we're in the midst of the cyclical lows. But I do think the fundamentals as we've highlighted in the presentation bode well for a recovery as we go to the backend of this year and certainly into 2019.

Ken Hoexter: Okay. All right. Thanks, Kevin. Thank you very much. Appreciate the time.

Kevin Mackay: No worries, thank you.

Operator: And at this time, that will conclude today's question-and-answer session. I'd like to turn the conference over back to Kevin Mackay for any additional or closing remarks.

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

Operator: And at this time, that will conclude today's conference. We do thank you for your participation and you may now disconnect.