TEEKAY TANKERS LTD.'S FOURTH QUARTER FISCAL 2019 EARNINGS RESULTS CONFERENCE CALL

Company: **Teekay Tankers Ltd**

Date: **Thursday, 27th February 2020**

Conference Time: **13:00 ET**

Operator: Welcome to the Teekay Tankers Fourth Quarter and Fiscal 2019 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 a 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 would like to turn the call over to management. Please go ahead.

Ryan Hamilton: Before Kevin begins, I'd like to direct all participants to our website, www.teekaytankers.com where you'll find a copy of the fourth quarter and annual 2019 earnings presentation. Kevin Mackay 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 fourth quarter and annual 2019 earnings release and earnings presentation available on our website.

I'll now turn over the call to Kevin to begin.

Kevin Mackay: Thank you Ryan. Hello everyone and thank you very much for joining us today for Teekay Tankers Fourth Quarter and Annual 2019 Earnings Conference Call. With me here in Vancouver, I have Stewart Andrade, Teekay Tankers' Chief Financial Officer.

Beginning with our recent highlights, on slide three of the presentation, Teekay Tankers generated total adjusted EBITDA of $132 million during the fourth quarter, more than double the $62 million reported in the fourth quarter of 2018. For the full year 2019, we generated total adjusted EBITDA of $259 million, up approximately 100% from the $129 million in fiscal year 2018. We reported adjusted net income of $83 million or $2.47 per share in the fourth quarter, up from an adjusted net income of $14 million or $0.42 per share in the fourth quarter of 2018. For the full year in 2019 we reported adjusted net income of $64 million or $1.91 per share, up from an adjusted net loss of $55 million or $1.63 per share in fiscal year 2018.

Our spot tanker rates in the fourth quarter of 2019 peaked at the highest level since 2008 and Teekay Tankers marked one of the most profitable quarters since the end of the tanker market super-cycle in 2009. Since the end of the third quarter of 2019, we have significantly strengthened our balance sheet with strong cash flow from operations, over $100 million of opportunistic asset sales, and completing our previously announced five-year $533 million revolving credit facility, which we will touch on it in more detail later in the presentation. Including all of these items, our proforma net debt at the end of the year was reduced by $153 million, or 15% since the third quarter of 2019. And our proforma liquidity at year end increased to approximately $260 million from $95 million at the end of last quarter.

The strength in the tanker market continued into the early part of the first quarter of 2020, and I'm pleased to report that we have secured significantly higher spot tanker rates to date than those achieved in the fourth quarter. While crude tanker spot rates have come under pressure in recent weeks, primarily due to the Coronavirus and the removal of sanctions against COSCO, we continue to believe the underlying tanker supply and demand fundamentals point towards an improved rate environment in the near medium term. I will touch on this in the next few slides.

Turning to slide four, we look at recent developments in the spot tanker market. Crude tanker spot rates saw extreme volatility during the fourth quarter of 2019 as shown by the chart on the right of the slide. The market initially started tightening in September as a result of firmer refining demand ahead of IMO 2020, and a slowdown in tanker fleet growth due to shrinking new-build deliveries and vessels being taken out of service for scrubber retrofitting.

The market received a significant boost in October from the removal of 26 COSCO-owned VLCCs from the trading fleet due to sanctions imposed by the United States. This tightened available fleet supply further exacerbating positive underlying fundamentals and caused tanker spot rates to spike to the highest levels since 2008. This spike in spot rates also drove an increase in time charter rates and Teekay Tankers took advantage of this window of opportunity by chartering out four Suezmaxes at very attractive rates, averaging $37,000 per day for average durations of 12 months. The window for chartering out at those levels was relatively brief, with rates correcting to more normalized seasonal levels at the start of November, as the market absorbed the news of the COSCO sanctions. Nevertheless, rates remained relatively firm and in the fourth quarter as a whole, rates average the highest since the last market peak in the fourth quarter of 2015 as shown by the chart on the left of the slide.

Spot tanker rates started 2020 on a positive note as the supply-demand fundamentals remained fully intact in the new year and various market events continued to support rates. However, rates in most segments have come under pressure during February due to a combination of weaker refining margins, the onset of seasonal refinery maintenance, the return of the COSCO vessels to the trading fleet, and the impact of the Coronavirus outbreak. I will discuss these factors in more detail on a later slide.

Turning to slide five, we give a summary of our earnings in the first quarter of 2020 to-date. Based on approximately 77% and 62% of spot revenue days booked, Teekay Tankers first quarter to-date Suezmax and Aframax bookings have averaged approximately $51,700 and $38,100 per day

respectively. For our LR2 segment, with approximately 65% spot revenue days booked, first quarter to-date bookings have averaged approximately $40,100 per day. In each segment, rates achieved to-date are significantly above those achieved during the fourth quarter. It's also important to note that we're currently trading the majority of our LR2s in the crude market, hence the LR2 earnings being comparable to those achieved by our Aframax fleet and at a substantial premium to earnings which could be achieved in the clean market.

As discussed in the previous slide, the freight market for most segments, except our US Gulf Aframaxes, have come off from the high seen at the start of the year, and we expect spot rates during the balance of Q1 to be at levels substantially lower than those booked in the quarter to-date for these segments.

Turning to slide six, we discuss some of the factors which will impact the tanker market over both the near and medium terms. In the near term, the tanker market faces a number of headwinds, most prominent of which is the recent Coronavirus outbreak. Although the full impact of the outbreak remains uncertain, it appears likely that the tanker market will be negatively impacted in the coming weeks or months due to a reduction in Chinese oil demand and associated refinery run cuts. In an effort to support oil prices, the OPEC+ group have also indicated the potential for additional supply cuts in the anticipation of reduced demand caused by the virus outbreak.

Although the near-term impact of the Coronavirus on the tanker market is clearly negative, there are off-setting factors which could mitigate a portion of the overall impact. Some refiners may look to take advantage of lower oil prices and a contango pricing structure by stockpiling cheaper oil. In addition, lower oil prices will also lead to lower bunker costs, which will help support spot tanker earnings.

We're also seeing delays to vessels discharging at Chinese ports, as well as delays at Chinese new-build yards and Chinese repair yards. This could help to tie up tonnage and will also likely extend scrubber retrofits further into 2020 than was previously expected.

In addition to the Coronavirus, the tanker market also faces headwinds in the near term and the return of the COSCO vessels to the trading fleet, weak refining margins in Asia and the onset of seasonal refinery maintenance. Although the near-term outlook for the tanker market is uncertain, we believe the underlying supply and demand fundamentals remain positive. Non-OPEC oil supply is expected to grow by over 2 million barrels per day in 2020 led by the US Brazil, Guyana, and Norway. This will lead to an increase in long haul Atlantic to Pacific crude movements and a stretching of the fleet, as more vessels will have to ballast back to the Atlantic to load cargo.

We also believe that global oil demand could experience a strong rebound once the impact of Coronavirus passes, particularly if the Chinese government acts to further stimulate their economy. The outlook for tanker fleet supply remains highly encouraging with the tanker order book currently at a 23-year low when measured as a percentage of the existing fleet. We also believe that scrapping could rebound this year as 13 million deadweight ton of tankers reaches 20 years of age. As highlighted earlier, fleet supply should also remain constrained through 2020 by ongoing vessel removals for scrubber retrofits. And finally, new tanker ordering remains at relatively low levels compared to previous market cycles due to a lack of available financing and uncertainty created by anticipated long-term changes to maritime regulations and new technology development.

In sum, while the Coronavirus creates a period of uncertainty, we believe the underlying supply and demand fundamentals are constructive for a return to a healthier rate environment in the medium term.

I will now turn over the call to Stewart to cover the next couple of slides.

Stewart Andrade: Thanks Kevin. Turning to slide seven, TNK continues to maintain significant operating leverage to the tanker market as highlighted by the two graphs on this slide. On an annualized basis, the rates we achieved in the fourth quarter of 2019 would result in over $320 million of free cash flow or over $9.50 per share. This is compelling relative to our closing share price yesterday of $12.66 per share and equates to a free cash flow yield of approximately 75%. From an earnings per share

perspective, using a similar methodology, it would translate into $8 per share, which can be seen in the graph on the right. This equates to a compelling 1.6x price to earnings ratio.

Turning to slide eight, we highlight significant balance sheet improvements that we have made since the end of the third quarter. Starting with the graph on the top of the page, we provide our debt repayment profile before and after the recently secured five-year $533 million revolving credit facility refinancing, which was approximately 2x oversubscribed. This attractively priced refinancing at LIBOR plus 240 basis points reduces our 2021 balloon maturities from approximately $390 million to approximately $70 million, with our next balloon maturity coming at the end of 2024. Including this refinancing and our previously mentioned asset sales, our pro forma December 31st liquidity is $260 million compared to $95 million at the end of the third quarter.

Our balance sheet leverage has also improved with net debt to capitalization decreasing by 5% from 51% at the end of the third quarter, to 46% on a pro forma basis at December 31st. Our net debt, which includes our debt and capital lease obligations, less cash on hand, has reduced significantly since the beginning of 2019, as shown by the graph on the bottom of the page. Taking into account cash flows earned from the improved tanker market and proceeds from agreed assets sales, our pro forma net debt at the end of the year stands at $844 million. A decrease of over $200 million or approximately 20% since the end of 2018; and a decrease of $150 million or approximately 15% from the third quarter of 2019.

In 2020, we will continue to allocate capital toward debt reduction as we think this will create the most shareholder value by increasing our net asset value, better positioning us to exercise purchase options on higher cost sale leaseback debt, thereby reducing our cost of capital, and strengthening our balance sheet, which will build further our financial flexibility.

I will now turn the call over to Kevin to conclude.

Kevin Mackay: Thanks Stewart. Turning to slide nine, we have summarized our execution on many of the strategic priorities that we laid out at our recent Teekay Group Investor Day in November with the goal of creating shareholder value and strengthening our balance sheet.

Operationally, we have maintained our high spot market exposure while locking in attractive time charters when the market spiked in October. Financially we have increased balance sheet strength by aggressively reducing debt and pushing out maturities. On the asset side, we have opportunistically agreed to sell more than $100 million of assets, further accelerating our debt reduction and exiting any non-core business. And lastly on IMO 2020, I am pleased that we have had a very smooth transition to burning lower sulfur, more environmentally friendly fuels, which we attribute to our extensive preparations over the past three years and to having secured supply contracts with quality fuel suppliers, covering approximately 75% of our requirements.

Given our leverage to the tanker market and tanker supply and demand fundamentals pointing towards a healthier rate environment in the medium term, we expect to continue creating significant shareholder value and increasing our financial strength.

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

Operator: Thank you. If you'd like to ask a question, please signal by pressing star one on your telephone keypad. If you're using speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star one to ask a question. We'll pause for just a moment to allow everyone an opportunity to signal for questions.

Our first question in the queue comes from Randy Giveans with Jefferies. Please go ahead.

Randy Giveans: Howdy gentleman, how's it going? All right. So, yeah, with the number of the recent asset sales and the debt refinancing, how do you balance delevering versus share repurchases with the use

of cash? Wouldn't the share repurchases at steep discounts to NAV be more accretive to NAV than just straight debt repayment? Because frankly TNK is pretty ridiculously valued on price and NAV, EBITDA, PE and the other valuations. So, today's, whatever it is, 20% uplift makes some sense there. TNK shares are still undervalued, I guess. So, what is your current share buyback authorization and maybe plans going forward?

Kevin Mackay: Thanks Randy. A good question. I think it's important to remind everybody on the call of what we spoke to the market about at our Investor Day and our beliefs that as we move through 2020, our focus really needs to be on reducing our debt levels, and more importantly, taking out some of the expensive, sale leaseback cost of capital that we have. So, we are committed to focusing on debt repayment in 2020. And although asset – sorry, although share prices fluctuate, our focus remains tied to our strategy that we laid out at Investor Day.

Randy Giveans: So, would you say no share repurchases in the near term? Is that fair?

Kevin Mackay: I think for the time being where we're going to continue to focus purely on debt repayment. And although we've built up a fairly significant cash position, it's important to remember those sale leaseback transactions that we want to take care of, which don't actually – we can't actually get to those until later in the year. So, we're setting aside that money to be able to eliminate that expensive cost of capital.

Randy Giveans: Okay. Is there a kind of target net debt to cap or net debt to EBITDA or some kind of leverage ratio that you'd like to get down to? Is it zero, or what are you trying to – how do you – how under-levered are you hoping to get in 2020?

Kevin Mackay: The market will be what the market will be and that will drive what's what we're able to do in terms of debt reduction. Our focus is really to execute on the strategy that we laid out and that strategy spoke to focus on debt repayment throughout 2020. So that's what we're going to be updating our Board with, and that's what our focus will be on for this year.

Randy Giveans: Okay. All right. Well, one more question for me. Looking at the quote in your press release, 'secured supply contract, covering approximately 75% of fuel requirements in 2020,' is any of that hedged or pre-purchased, or is it just the agreement for a quantity with the price to then be determined later?

Kevin Mackay: It's primarily supply availability contracts to make sure that we're getting access to quality, low sulfur fuels. But also, we've got a number of different contracts with different suppliers and in those we have different pricing structures based on spot rates, averages, things of that nature. So, it's a blend of different approaches.

Randy Giveans: Got it. But not necessarily bought forward that is tying up working capital or anything?

Kevin Mackay: No.

Randy Giveans: Okay. All right. Well, that's it for me. Good quarter. Thanks so much.

Kevin Mackay: Thanks very much, Randy.

Operator: Our next question in queue comes from Jon Chappell with Evercore ISI. Please go ahead.

Jon Chappell: Thank you. Morning, Kevin, or good afternoon. I think your strategy is quite clear and obviously there's a bit of disruption in the market right now and that may create some opportunities, but it sounds like you're still more of a seller than a buyer. Given Teekay's platform and your historical or legacy performance, do you see opportunities for charter ins from some owners who may not have the platform that you have and – or the market relationships to use this opportunity of weakness to get more market exposure without the use of capital?

Kevin Mackay: Yeah, I think it's something that we've spoken about on previous calls. One of the strengths that we see in our management structure and our commercial capabilities is that ability to out-charter and in-charter. And as you saw us doing during the COSCO spike, we put some ships out at what we felt was fairly attractive numbers to lock in for a 12-month period. The flipside of that now that the market has come off, we're definitely looking, we're interested. And I think as the opportunities arise, I've said this before, we've got five in-charters at the moment that we would look to try and expand that book if we can get the right kind of rates. And I think there probably will be opportunities arising as we move through the lower quarters that we traditionally see in the market, Q2 and Q3.

Jon Chappell: That makes sense. And then the follow-up to the last question about the fuel as well, I understand that you're not tying up the working capital, but is there a price that's already been established for that? And the reason I ask is because obviously at the beginning of this year, there was a pretty widespread right off the bat. And then, the market turmoil, commodity prices have collapsed. So, have you locked in a significant part of that 75% at prices at that maybe a little bit high relative to where we are today? Or it's just strictly a supply, almost a COA? It's going to be a floating price based on when you actually need that cargo, that fuel.

Kevin Mackay: Our expertise, Jon, is in chartering tankers, not trying to figure out what bunker prices are going to be or oil prices will do. So, those supply contracts, they lock in volume – well, they lock in a spread of volumes so we have flexibility in operating our fleet, but it doesn't tie in any flat pricing mechanism where we're tied to a specific price, flat price.

Jon Chappell: Right. All right. Thank you, Kevin.

Kevin Mackay: Thanks John.

Operator: Our next question in queue comes from Omar Nokta with Clarksons Platou Securities. Please go ahead.

Omar Nokta: Hi Kevin, hi Stewart. Stewart, you mentioned in your opening remarks, the potential unwinding of the sale leasebacks in order to reduce your cost of capital. Do you see that as a 2020 event or is it more about deleveraging in 2020 and then in 2021 maybe start to refinance those lease backs?

Stewart Andrade: Right. I think the two things are tied. So, obviously our ability to exercise those purchase options and reduce that expensive debt will be tied to how 2020 plays out in terms of the spot rate and how much cash flow we generate. So I think the two are very much connected, but those purchase options come up in the third quarter of this year and if we're in a position to exercise those, we will look to do that.

Omar Nokta: Okay. Got it. Thank you. The next question is just on the dry docking costs; what should we be thinking about from a model perspective? And obviously 2019 was pretty heavy. I think it was about somewhere on $45-50 million of dry dock costs. What should we be thinking about for 2020 and 2021?

Stewart Andrade: So I have the 2020 numbers in front of me; for 2021 we'll have to take it offline. But for 2020 for the full year, including doing some ballast water treatment installations, we're looking at a total of about $42 million. We don't have any in Q1 and those are basic – those expenses will basically be incurred in Q2 and the bulk of it in Q3.

Omar Nokta: Okay, thanks. And maybe just finally, just one other question. Maybe on the commercial operations, you outlined the nine LR2s that are switched to dirty. Obviously there's been a lot of talk in the markets about owners wanting to do that and you guys have clearly done it and it's based off the $40,000 you've achieved thus far into Q1, it's clearly an out-performance relative to clean. When you guys made that decision to switch into that trade, were you thinking of looking to take advantage of a hot market for the next couple of cargoes? Or did you see yourselves wanting to stick with it for a couple of years? Maybe just explain that dynamic and also the thought process of what it would take to bring them back to the clean trade if you wanted.

Kevin Mackay: Well, let me answer your last question first. It would take a nice margin, incremental margin for LR2s to outperform Aframaxes before we will start switching them back over. The beauty of the LR2 is that flexibility, and I think we've spoken about this in the past. We don't look at those ships as clean LR2s. We look at them as fungible assets that we can move in and out of the market as we see the forward curves moving. We started to move more of the fleet across into dirty throughout the early part of 2019 because Aframax rates were outperforming. We do look at it on a voyage-by-voyage basis, but it's also with a view to what is the forward market going to do over the next three to six months and we take a position based on that view.

So we'll continue to do that. At the moment it seems clear that, although Aframax rates have dropped off, ships that we have that are – LR2s trading in the US Gulf at the moment are earning $35,000 a day. So the answer to keep them dirty is made for us by the rates we're getting in that space.

Omar Nokta: Yup. That's clear. Okay, well, I'll leave it there. Thanks Kevin.

Kevin Mackay: Thanks Omar.

Operator: Our next question in queue comes from Ari Rosa with Bank of America. Please go ahead.

Ari Rosa: Hey, afternoon guys. So, just wanting to get an update on how are you thinking – obviously there are a lot of vessels moving in and out of your portfolio between Q4 and Q1. How are you thinking about opportunities to buy and sell vessels in this market? And just for modelling purposes, could you specify it, so where does the actual fleet stand in terms of number of ships on spot and number of ships on charter?

Kevin Mackay: In terms of the figures we have, I think we're down to 55 ships in total. And of those we have five on time charter out at the moment. In terms of theasset purchase approach, I think we were fairly clear in our November Investor Day presentations and nothing has changed since that point. We don't

have a view to be purchasing any ships in this market. Asset prices are at a price point that we don't feel there is a value, so we will not be buying anything.

In terms of the sale of assets, we've been – and we've said we will be very opportunistic about it. And as you've seen us do with the four ships we sold since Investor Day, we felt that we were approached with numbers that we feel added value, it was worth taking the ships out. So we did four of them. As we move forward, obviously a lot will depend on where the spot market goes and how that impacts the asset values. And we'll treat each and every opportunity that arises on a one-off basis, clearly with a view to what is the best value we can generate from the sale versus ongoing trading.

Omar Nokta: Sure. That makes a lot of sense. And then just on a similar vein, maybe you could talk about your thinking, particularly with the COSCO disruption, how you guys were thinking at the time about the desirability or even the availability of securing long-term charters. And how you're thinking now about what you'd like your spot exposure to be versus if you had additional opportunities to charter vessels, what rates you would be looking for, if you could secure that.

Kevin Mackay: I think what happened during the COSCO spike was the underlying fundamentals to the market started to improve in September. The extraction of the 26 Costco VLCCs poured gasoline on an already burning fire. So we took that opportunity to look at the time charter market and there was various participants in the market that panicked and wanted to grab all the ships because they thought that that spike was going to last forever. And on that basis we clearly took advantage and locked in four ships for 12 months.

I think that was a one-off event. Although the underlying fundamentals of the market are still relatively strong in the medium term, I think the way time charter rates have come off because of the Coronavirus, it's not a point in the market that we'd want to repeat that kind of transaction. So we will sit tight, we'll keep our powder dry and we'll see what develops both in the spot market and in the time charter market where you see us do any more executing of that nature.

Omar Nokta: Okay. I mean that makes a lot of sense. Of course. Is there a price at which you think you would feel comfortable putting more vessels on charters? And maybe if you could give some color on what that price might be?

Kevin Mackay: It isn't a fixed price. It's all relative to what we think we can get if we don't lock in that rate and we keep the ship trading in the spot market. So, a lot will depend on our forward view of the spot market and that varies from period to period depending on what's happening in world events and with crude oil demand and refinery runs. And, it's something that we look at almost on a daily basis. And we certainly speak as a management team daily, weekly to ensure that we are positioning the fleet and the portfolio that we have both in-charter and out-charter to try and maximize our earnings.

Omar Nokta: Sure. That makes a lot of sense. Okay. Thank you for the time.

Kevin Mackay: Thanks Omar.

Operator: There are no more questions in queue. And at this time I would like to turn the call back over to Kevin Mackay for closing remarks.

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

Operator: This concludes today's call. Thank you for your participation. You may now disconnect.