TEEKAY LNG PARTNERS' SECOND QUARTER 2019 EARNINGS RESULTS CONFERENCE CALL

Company: **Teekay LNG Partners L.P.**

Date: **Thursday, 1 August 2019**

Conference Time: **11:00 ET**

Operator: Welcome to Teekay LNG Partners Second Quarter 2019 Earnings Results Conference Call. During the call, all participants will be in a listen-only mode. Afterwards, you will be invited to be participated 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 question. For assistance during the call, please press star zero on your touchtone phone. As a reminder, this call is being recorded. Now for your opening remarks and introduction, I would like to turn the call over to Mr Mark Kremin, Teekay Gas Group's President and Chief Executive Officer. Please go ahead sir.

Scott Gayton: Before Mr Kremin begins, I would like to direct all participants to our website at www. teekaylng.com, where you will find a copy of the second quarter 2019 earnings presentation. We 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 2019 earnings release and earnings presentation available on our website. I will now turn the call over to Mark to begin.

Mark Kremin: Thank you, Scott. Good morning everyone, and thank you for joining us on the second quarter 2019 earnings conference call for Teekay LNG Partners. I'm joined today by Scott Gayton, Teekay Gas Group's CFO.

Turning to slide three of the presentation, we will review some of Teekay LNG's recent highlights. Similar to last quarter, we continued to improve on our year-over-year and quarter-over-quarter results, as can be seen on the charts to the right of this slide.

We generated total adjusted EBITDA of $162.1 million, which was up 2% over last quarter and 41% over the same quarter last year. Adjusted net income of $34.4 million, up 3% over last quarter and 154% over the same quarter last year, and adjusted EPU up $0.35 per unit up 3% over last year and 289% over the same quarter last year.

Our second quarter results were up primarily due to the delivery of LNG carrier newbuilds and the commencement of charters at higher rates for certain of our LNG carriers, partially offset by an increase in dry dock days during the quarter and waiting time prior to the commencement of recently secured LNG charters at higher rates.

Importantly, we expect our results for the second half of the year will continue increasing now that the new charters have commenced leading to higher utilization and higher revenues, coupled with further newbuild deliveries and fewer dry dock days. For more details on our quarter-over-quarter financial performance and third quarter guidance, please refer to the appendices of this presentation.

We're pleased to report that all of our LNG carriers are now serving under period charters. As a result, our LNG fleet is 100% fixed through the middle of next year, 97% fixed for 2020, and 92% for 2021 respectively at rates well above the current spot market.

We still anticipate our 2019 financial results will fall within the ranges indicated on this slide, which translates into attractive valuation multiples, as Scott will discuss in a moment. We continue to be frustrated with our unit price trading below our intrinsic value, and we believe it does not reflect our strong financial outlook.

While delevering remains our top priority and we have been able to make good progress on this front, as we will discuss, we were also able to make attractive returns by opportunistically repurchasing our common units at compelling prices. Since last reporting earnings in May, we have repurchased approximately 284,000 units at an average price of $13.78 per unit for a total cost of $3.9 million.

Since commencing our repurchase program late last year, we have repurchased 1.43 million units or 2% of our outstanding units immediately prior to commencement of the program for a total cost of $16.9 million, and at an average per unit price of $11.86, which compares very favorably to today's trading price and to our intrinsic value.

We're pleased to report that our smaller LPG segment generated stronger results quarter-over-quarter and year-over-year, now that our seven wholly-owned multigas carriers have transitioned to the Lauritzen Kosan pool, and we are already seeing the benefits of pooling in terms of increased cash flow.

Looking at slide four, we will now look at recent developments in the LNG and LPG shipping markets. As can be seen in the left-hand chart, spot LNG rates have rebounded from the first quarter, but remain depressed due to typical seasonal weakness, and an oversupply of vessels. Chinese imports in the second quarter grew by 17% compared to the same period last year. However, Japan and South Korean imports were limited as both countries restarted nuclear reactors.

This contributed to weaker LNG prices in Asia and limited arbitrage trading between the Atlantic and Pacific basins. As a result, Atlantic Basin LNG cargoes landed in Europe instead of transiting long haul to Asia. While global LNG trade growth was minimal in the second quarter of 2019, the LNG fleet grew by 2.5% in total cubic meter capacity. This combination of moderate fleet growth outpacing minimal trade growth resulted in LNG vessel spot charter rates averaging approximately $48,600 per day for a 160,000 cubic meter vessel in the second quarter of 2019 well below, where we were booking one-year LNG charters earlier this quarter.

Looking at the chart on the right, charter rates for midsized gas carriers or MGCs to which we have exposure through our Exmar joint venture have reached a two-year high of $17,500 per day for one-year time charters. This strengthening in rates was driven by strong imports into India as government policy saw a shift from coal to LPG in rural cities.

Furthermore, LPG demand in Asia is anticipated to accelerate this year as new propane dehydrogenation facilities or PDH facilities are expected to come online. Although MGC rates have strengthened, small ethylene carrier rates or those earned by our seven wholly-owned multigas carriers have remained flat at approximately $12,000 per day. However, as rates improve for the larger vessels, we are anticipating a knock-on effect supporting rates for these smaller vessels. I will now turn the call over to Scott to run through the rest of the slides.

Scott Gayton: Thank you, Mark. We presented the chart on slide five last quarter, and I wanted to take a moment to run through it again because we believe it is important. We've already made good progress with our delevering efforts, having reduced leverage on a net debt to annualized quarterly adjusted EBITDA basis from nine times at the end of Q2 2018 to 6.7 times at the end of Q2 2019.

And we expect this trend to continue as can be seen in the visual depiction of the scheduled debt reduction payments, we expect over the next few years. Decreasing from a total debt balance including our proportionate share of JV debt of approximately $5.2 billion currently down to $4.4 billion by the end of 2021, which equates to a net debt to total adjusted EBITDA ratio of approximately 5.3 times or a net debt to book cap ratio of around 50%.

This delevering profile is important to today's unitholders because not only does debt pay down accrete directly to equity value, but it also provides us with greater financial flexibility.

I'd also like to take a moment to provide more details on our consolidated current portion of long-term debt balance, which increased from $136 million last quarter to over $400 million at the end of Q2 2019, which comes due over the next 12 months. $150 million of this current portion relates to two LNG carriers, which are subject to purchase obligations by Awilco at the end of this year, with a portion of such proceeds expected to be used to repay these loans in full, and $115 million or $134 million on a notional basis related to a Norwegian bond that matures in May of 2020, which we anticipate repaying or possibly rolling depending on the pricing and use of proceeds. And the remaining $137 million is comprised of our regular scheduled debt reduction payments.

Turning to slide six, as Mark mentioned earlier, we remain comfortable with the financial guidance we provided last quarter, and with 100% of our LNG fleet booked through the middle of next year, we are confident that our actual 2019 results will come within the guidance ranges provided, which shows a significant increase in both adjusted net income and adjusted EBITDA.

Our 2019 adjusted net income and EPU guidance includes approximately $30 million of deferred revenue, which will be realized in connection with the Awilco purchase obligation, whereas, the 2019 consolidated adjusted EBITDA and total adjusted EBITDA guidance metrics have been normalized to exclude any Awilco deferred revenue.

In addition, the total adjusted EBITDA guidance range for 2019 has been adjusted by $30 million to $665 million to $690 million to be consistent with the calculation method as described in the earnings released. I will now turn the call over to Mark to conclude.

Mark Kremin: Thank you, Scott. We are encouraged by the trend we are on right now with growing earnings and cash flow and declining leverage because we believe this sets us up well to continue adding equity value for unitholders while making Teekay LNG an even more attractive investment opportunity for new investors.

Before opening the line to Q&A, we wish to finish the call today on slide seven with a formal save the date, and we invite you all to our Investor Day at the Grand Hyatt Hotel in New York City on 2nd October, where we will cover the strategy, financial position, and market outlook for the Teekay Group.

Registration starts at 08.00 am. Eastern with presentations between 08.30 am and 11.30 am Eastern followed by one-on-one meetings. Please RSVP at the link on slide seven, and if you would like a one-on-one meeting, please contact Emily Yee at Emily.yee@teekay.com. We look forward to seeing you all there. Operator, we are now available to take questions.

Operator: Thank you very much. If you would like to ask a question, please signal by pressing star one on your telephone keypad. If you are using a speaker phone, 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 will come from Chris Snyder, Deutsche Bank.

Chris Snyder: Hey, thank you for taking my question guys. So, the first question is around distribution growth. I mean, you obviously increased it pretty substantially this year and shares are yielding very healthy 5%. You have the capacity to pay more and grow over the coming years, but a lot of your peers don't really feel like they're getting paid for their distributions. Kind of how should we think about the growth trajectory here just as you guys are obviously ramping cash flows and newbuilds coming down? I know the focus is on deleveraging, but kind of how do you think about the dividend growth?

Mark Kremin: Good morning Chris and thanks for the question. Chris, we remain committed to our balanced capital allocation program, which currently prioritizes balance sheet delevering, while returning capital to unitholders.

Looking to distributions next year, 2020, we expect any potential increase to be modest as we continue to prioritize that delevering. And over the last year, we significantly reduced our financial leverage, as Scott has mentioned to around 6.7 times from 9 times a year ago. So, we're getting closer to the 5 times or 5.5 times target that we've discussed previously.

This balance sheet delevering is expected to build significant equity value and will also in turn then increase our distribution capacity in the future and build financial flexibility. Hopefully, that answers your question for now.

Chris Snyder: Yeah, for sure. And then kind of more of like a broader question. So, certainly, the LNG commodity price impact shipping rates, more on the spot side than on the term side, but how do you think about the market potentially entering a period of structurally lower prices? We're seeing global energy majors increasingly pivot towards LNG, take risk in bringing projects online, and with that the big build and supply, you would think is, could result in a structurally lower commodity price environment. Just so how do you rethink about that and what could it mean for shipping markets?

Mark Kremin: So, you're right. The long-term LNG price, which is about $9 is now closer to $5 on the spot market. In the near term, and I know that's not what you've asked for, but in the near term, we've obviously has discussed in the prepared remarks are seeing a lot of shipping in the Atlantic Basin, in particular stay in that basin. So, Europe is way up and China is up to some extent, but Japan and Korea look like they're going down, and also some of that is attributable to the nuclear restarts, which were also dampening prices a bit.

But in the long-term, if we look at what lower prices might be – and if this is – it retains and remains as it is, where we're going to have lower pricing on Henry Hub in particular out of the US, it's not a bad thing necessarily. As we know, low price gas will result in more fuel switching and more use of gas, and as we increase our use of that, so will the LNG even if the pricing is low.

So, we are seeing on a shipping basis, the arbitrage is certainly not there. But fundamentally, if we can have low gas and begin to push out some of these other higher price commodities, that's a good thing, and I think it's a good story for LNG.

Chris Snyder: I appreciate that color. And then just lastly real quick. Obviously, LPG market has gotten better in 2019. I think in the past, you guys have said that the consolidated fleet of multigas carriers is not considered core. Are you guys thinking about potentially divesting that asset group, or do you still think kind of there's ways to go on the LPG recovery and you'd see a better price in the future?

Mark Kremin: Well, we're certainly happy about it than we were last year. As you've seen our earnings, it is making a much more positive impact this year. And thanks go out to our pool partners and Lauritzen Kosan, they're doing a good job. With that said, however – and they understand it is still not our core business. It's a relatively small part of our business, and I'm not sure exactly when we might divest, if and when I should say, and it's certainly not in the very near term I wouldn't think because we're not in a position where we have to sell. So, as we mentioned in our prepared remarks, it is lagging even the MGCs and the recovery, but we think it will get there and it's a knock-on effect. And when it does, and when it comes back, we're going to have a good pool partner running us; until then, we can take another look at whether this is – it should be divested at that time.

Chris Snyder: Make sense, so that does it for me. I appreciate the time.

Operator: Thank you very much. Our next question will come from Randy Giveans, Jefferies.

Randy Giveans: Howdy, gentlemen, how is it going?

Mark Kremin: Hi great. Thanks.

Randy Giveans: Hey. So, in the past, you provided a slide kind of showing the remaining Capex and your completed kind of undrawn debt financings. But for example, at the end of 2Q last year, you had about $1.25 billion of remaining Capex and about $1.1 billion in your completed and undrawn debt financing. So, can you provide an update for those two amounts at the end of 2Q 2019?

Scott Gayton: Sure. Hi Randy. So, we've got approximately $350 million of remaining Capex, and that's all actually down in our various joint ventures whether it be the Yamal vessels or Bahrain, and offsetting that $350 million of remaining Capex as of 30th June, we have approximately $300 million of undrawn financings.

Randy Giveans: Perfect. And then focusing on the balance sheet here, trying to just quantify your focus on delevering, what is your expected debt repayment for the rest of this year and then 2020?

Scott Gayton: Yeah, so if you look at that slide that we prepared on five, we do show that our consolidated debt payments whether it's – so that's on the GAAP basis, is just under $200 million per year. And if we include our off-balance sheet joint ventures, then we end up at approximately $300 million total for the year. So, over the next couple of years on a consolidated basis and including all of our joint ventures, we're reducing debt by around $300 million per year.

Randy Giveans: Okay, I'll use that for run rate. And then lastly, you mentioned unit repurchases have continued since May. You also mentioned just a few minutes ago that any possible distribution increases would likely be maybe modest next year. So, with that, do you expect continued unit repurchases as a priority in the coming months? And how much do you have remaining in your authorization?

Mark Kremin: Remained in the authorization is about –

Scott Gayton: It's about $80 million.

Mark Kremin: Yeah. In terms of repurchasing, yes, if we have dips such as we're seeing right now, I think we'll continue to buyback. We do look at it periodically and we'll be seeing our board again in September, but it's something we do take advantage of if we can.

Randy Giveans: Good, all right. Well, that's it for me. Thank you.

Operator: Thank you. Our next question will come from Ben Nolan, Stifel.

Ben Nolan: Hey, good morning, guys.

Mark Kremin: Good morning.

Ben Nolan: So, I have a handful. Number one – and I know on slide number five, and Scott you called out the $150 million Awilco-related debt that's now moved into current based on their purchase obligation. Any color on how you're thinking through that? Is that something that we should be modeling those vessels are in fact repurchased, or any color around maybe discussions that you've had about that?

Mark Kremin: Well, the current status is what it was. They have a purchase obligation that is due at the end of this year, so that's what we're following at this point.

Ben Nolan: Okay, all right. Switching gears a little bit then. If you mentioned it, I didn't catch it. Do you have any update on where things stand with respect to Bahrain and how close things are there to crossing the finish line?

Mark Kremin: We still see it as a second half of the year event. We are right now in commissioning. And when I say we, it's the Bahrain LNG terminal is commissioning. We own about 30% of the terminal and we have the 100% of the FSU. The FSU is on hire, and it's been on hire for all year actually. In the terminal side, the commissioning is – we are finding things from time to time and this is the point of commissioning.

As we look at our repair times and that you need when you find issues or the long leads, it still looks like the Q second half event that we have been forecasting as of last quarter.

Ben Nolan: Okay. But it should – reading into that probably not September or August, right? It's maybe closer to October.

Mark Kremin: I think it is possible as we commission now and it's possible and right now we're commissioning – we've done air and we've done different types of gases and water and other things. We haven't yet commissioned the LNG and when we do that, I think it's possible that we do slide into Q4.

Ben Nolan: Okay, great. And then lastly, just on the LPG side. As you mentioned rates are higher which, obviously, was a little helpful in the quarter. It seems like there's pretty good momentum there. As you think through that business strategically and especially with the midsized vessels they have in JV with Exmar, what's the chartering strategy – as availability in the market for longer-term charters begins to open up a little bit, is that something that you would like to do or is this just more of the same in terms of the chartering strategy with the kind of mix?

Mark Kremin: The MGCs are a little bit different than some of the other sectors, in that, they do offer a little bit more cover. You can get some more cover than you can in VLGCs for instance certainly, and we are fortunate on our ethylene business. Kosan does have some cover there too, and it's one of the reasons I think we're doing better. They have CoAs.

On the cover side and what we would do at the Exmar, they're currently for the year they have a fair amount. We're about 80% or so fixed for this year. For next year, we're also – we have over 30%. I think it's nearing 40% or so cover for next year, so it is a little bit different from the VLGC space. That said, the cover that the Exmar and JV has been looking at is obviously creeping up in terms of the rates.

So, we're never fully spot chartered out, but the cover that we've been seeing right now and taking is at higher rates. Just one more point on this. The cover that you can possibly get and that we are getting is a little shorter than you would see on the LNG. So, you typically don't get more than one, two or three years or so. So, as we roll off on these MGCs, we should naturally start to see the higher rates even if the ships are covered right now.

Ben Nolan: All right, great, appreciate it, Mark. That's it from me. Thanks.

Operator: Thank you very much. Ladies and gentlemen, that's all the questions that we have for today. So, I would like to turn this conference back over to Mr Mark Kremin for closing remarks.

Mark Kremin: Well, thanks everyone for your ongoing support. We hope to see you all at the Investor conference on – in New York City on 2nd October. Thanks again. Bye-bye.

Operator: Thank you very much. Ladies and gentlemen, at this time, this now concludes today's conference. You may disconnect your phone lines and have a great rest of the week. Thank you.