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

Company: **Teekay Tankers Ltd.**

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Conference Time: **12:00 ET**

Operator: Good day, and welcome to Teekay Tankers Ltd 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 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 touch-tone phone. As a reminder, this call is being recorded. Now, for opening remarks and introductions, I would like to turn the call over to Mr Kevin Mackay, Teekay Tankers Ltd's Chief Executive Officer. Please go ahead, sir.

Speaker: Before Kevin begins, I'd like to direct all participants to our website at www.teekaytankers.com, where you'll find a copy of our Second Quarter 2019 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 2019 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 2019 Earnings Conference Call. With me here in Vancouver, I have Stewart

Andrade, Teekay Tankers' Chief Financial Officer, and Christian Waldegrave, Director of Research, Teekay Tankers.

Beginning with our recent highlights on slide 3 of the presentation. Teekay Tankers generated total adjusted EBITDA of $36 million during the second quarter. Up from $17 million in the second quarter of 2018. We reported an adjusted net loss of $12 million or $0.05 per share in the second quarter; up from an adjusted net loss of $29 million or $0.11 per share in the second quarter of 2018. Our improved quarterly results, year-on-year, points to the improved underlying fundamentals in the market this year. However, they were impacted by seasonal factors as well as some near-term headwinds which I will touch on in more detail on the next slide.

Continued strong growth of US crude exports has helped bolster our full-service lighterage business and drove our average Aframax crude tankers spot rates to over $20,000 per day during the quarter. Our spot tanker rates, during the second quarter were significantly higher compared to the same period of the prior year. Rates in third quarter, thus far, have been affected by seasonal summer weakness. However, supply-and-demand fundamentals are signaling towards a firming tanker market in the latter part of 2019 and into 2020. I'll cover our market outlook in more detail later in the presentation.

Turning to slide 4, we look at recent developments in the spot tanker market. As shown by the chart on the left, last quarter saw our strongest Q2 earnings since 2016, with average Aframax rates being particularly strong. The reasons for which I'll highlight on the next slide.

Rates have weakened at the start of the third quarter, which is partly due to normal seasonality and partly due to some near-term headwinds. However, the chart on the right illustrates the increase in rate volatility we have witnessed this year compared to the same period of last year, which would include a tightening in the supply-demand balance. This is an encouraging sign as we head towards the seasonally stronger fourth quarter.

Turning to slide 5, we look at the growth in US crude oil exports and how this has led to increase lightering demand and our improved Aframax earnings. US crude oil exports continue to set new highs, with exports averaging three million barrels per day during the second quarter. Approximately 50% of all crude oil exports from the US have been shipped to Asia in 2019, with a large increase in cargo volumes to India and South Korea replacing volumes to China that have decreased. These volumes to Asia are primarily carried on VLCC's which require reverse lighterings via Aframax's due to draft constraints in US ports. This has led to an increase in lightering demand with rates commanding a premium to the Aframax spot voyage market. This boosted our Aframax earnings in the second quarter by around $4000 per day compared to the peer group average, demonstrating the value contribution of our full-service lighterage business.

US crude oil exports are projected to continue to rise over the next 18 months as new pipeline capacity linking the Permian Basin to the US Gulf Coast is completed. As shown by the chart of the slide, US crude oil exports are anticipated to reach 4 million barrels per day by the end of this year and could rise to as high as 5 million barrels per day by the end of 2020. This should be positive for mid-size tanker demand due to the further increase in both Aframax lightering demand and direct exports to Europe on Aframax and Suezmax vessels.

Turning to slide 6. As discussed earlier, normal seasonality and near-term headwinds have impacted our rates through the early part of the third quarter to-date. Based on approximately 37% of spot revenue days booked, Teekay Tankers third-quarter to-date Suezmax and Aframax bookings have averaged approximately $15,600 and $12,800 per day respectively. For our LR2 segment with approximately 32% spot revenue days booked, third quarter to-date bookings have averaged approximately $12,200 per day.

However, turning to slide 7, market fundamentals point towards a tightening of supply and demand drivers through the latter part of 2019 which is anticipated to increase volatility, which typically move freight rates higher. Starting with demand, we continue to see several positive factors which will help drive a tanker

market recovery in the coming months. Global refinery throughput is projected to be 2.4 million barrels per day higher in the second half of this year. It should create a significant uplift for crude tanker demand.

In addition, a boost from the upcoming IMO 2020 regulations may also lead to new trade patterns and arbitrage movements, floating storage and increased port congestion. Higher US crude oil exports, as detailed in the previous slide, should also be a positive factor as new Permian Basin pipelines come online in the coming months. We do also acknowledge, however, that some of the demand-side factors look less positive than at the start of the year. Global oil demand estimates have been revised down to 1.1 million barrels per day in 2019. However, the IEA projects a rebound to 1.4 million barrels per day, demand growth for next year.

OPEC's decision to extend supply cuts through to March 2020 is also a negative for near-term crude tanker demand. Although it should be noted that Saudi Arabia's currently producing around half a million barrels per day below their agreed production target, which gives them scope to increase supply without having to revisit their official policy. Finally, the impact of US sanctions on Venezuela continues to have a negative impact on mid-size tanker market in the US Gulf carriage market.

Turning to fleet supply. The next two years looks set to be a period of low fleet growth due to a shrinking order book which currently stands at just under 9% of the existing fleet size. The lowest since 1997. Shipyards are currently booked through to mid-2021, which gives us a two-year runway where fleet growth is expected to be only around 2% versus the historical average of around 5%. Fleet growth could be further dampened in the coming months by an increase in off-hire time as vessels are taken out of service to retrofit scrubbers. The one negative is that tanker scrapping has been lower than anticipated in the first half of the year, which is leading to slightly higher fleet growth so far than was forecast.

Turning to slide 8, we look at our tanker fleet utilization forecast out to 2020. We have updated our outlook based on the changes to the supply and demand factors identified in the last slide. While this has led to a slight downward revision to our forecast, it should be highlighted that utilization rates, around 86% or

higher, generally reflects tight market conditions which should lead to an improved market developing through 2020 with tanker fleet utilization approaching the 90% mark. Tanker market fundamentals continue to support market recovery in the latter part of the year, and with a healthy liquidity position and significant operating leverage, we believe Teekay Tankers is well-positioned to benefit from improving market conditions over the coming year.

Turning to slide 9. Before we open the line for questions and answers, I would like to invite you to Teekay Tankers Investors Day at the Grand Hyatt Hotel in New York on 2nd October where the management of Teekay Tankers will provide an update on the strategy and outlook for our business as well as an in-depth review of our outlook for the crude tanker shipping market. Registration starts at 08.00 am Eastern Time, with presentations between 08:30 am and 11:30 am Eastern. Followed by one-on-one meetings. Please RSVP at the link on slide 9. If you would like to have one-on-one meetings, please contact Emily Yee at emily.yee@teekay.com. We look forward to seeing you all there.

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

Operator: Thank you. Again, if you would like to ask a question please press star one. We'll take our first question from John Chapelle of Evercore.

John Chappell: Thank you. Good morning, Kevin. I want to start with slide 5 on the lightering. I think that's really interesting, the $4000 number that you noted and you show here on the slide. A couple questions on this. So, with the pipeline capacity building out, I'm trying to understand the competitive landscape and the opportunity for TK as far as lightering's concerned. Is there enough capacity in your fleet or in the broader lightering fleet to meet the new pipeline capacity?

And then also, part two. Is there any consolidation opportunities within that segment? It's a little bit more under-the-radar then we're used to in international shipping.

Kevin Mackay: I think, if you look at the volumes we're seeing in the lightering space, it's a combination of both import and export volumes that we see. Over the last year – obviously due to the OPEC cuts, we're seeing the import volumes reduce slightly and our balance between the two has driven more towards a higher percentage being export. With the pipeline capacity coming on, obviously, that portion of the business on the reverse lighterings is expected to grow.

What we are looking at is – as we balance our overall Aframax portfolio, at the moment, we are probably weighted 50-50 between Eastern markets and Western markets, but as we see more volume coming out of the US Gulf and the premium that we get out of the lighterage business, you'll probably see us start to position more ships towards the Atlantic and specifically the US Gulf to try and support that market. We also have the added lever to pull that you have seen us do this year as well as in previous years, where we can supplement our fleet by in-chartering third-party vessels. And we can do that either by putting them directly into the lightering trade or by exchanging the ships that we pull out of another market so we maintain a presence in those other markets while bolstering our Teekay presence in the US Gulf.

John Chappell: Okay. With that ability, you don't think there's any bottlenecks, potentially, from the lightering side to, kind of, maximize the exports from the US once those pipelines come out?

Kevin Mackay: I think, like any pipeline project, they will come out at different times. And some may get delayed, but it will certainly open up the bottlenecks that have been existing recently. I think, production-wise, earlier in the year we saw a build-up of inventories around the Cushing area. A lot of that was due to pipeline capacity not being there. I think as that plays out, we should start to see a lot more of the oil move. I think in terms of shipping bottlenecks, obviously, as more exports come out, as more ships transit in and out of port, the infrastructure in the US Gulf river system is fairly congested. And that may lead to further logistical delays which eats into tanker supply which is good for us.

John Chappll: Okay. And I'm sorry I cut you off. You might have been answering the potential consolidation opportunities in the lightering business.

Kevin Mackay: Yes, short answer really. It's not a big market. It's a very niche market with only a couple of players in it. While we have good co-operation around maximizing the utilization of our fleet, at this point, I don't see that been taken any further.

John Chappell: Okay. Final one. Maybe pull Christian in, if I may. Reading the press release, there were two, kind of, supply and demand things that stood out to me. One, was the big ramp in the IEA which we've, kind of, being talking about that as well. And, how do you think about the refinery run increase, sequentially, second half – first half, amid, kind of, what you guys talked about, a minus sign with fall in demand?

And then I'll add my second one now and then turn it over to you. The order book being at '97 levels is obviously incredibly appealing. However, you also mentioned the first half delivery schedule being the greatest since, I think, 2011 for a six-month period. So, how do you think about the timing of absorbing that into, kind of, the demand environment that we're looking at?

Christian Waldegrave: Yes, hi John. Taking your first point on the refinery runs. I think what we saw in the first half of the year and especially Q2 – I think it spilt over a little bit into the early part of Q3, with some very heavy refinery maintenance. But, we also saw some pretty low refining margins during Q2 especially in Asia around April-May time. I think that did lead to very low refinery throughput which affected the lower tanker rates that we're now seeing in the early part of Q3. But I think there are some encouraging signs there for the second half of the year. Refining margins in Asia have recovered. Just at the end of July, I thinkthey hit a two-year high. So, we would certainly expect refinery runs in Asia to start ramping up. And that period of maintenance is coming to an end as well.

So, we feel fairly confident that refinery throughput is going to be significantly higher in the second half of the year versus the first half of the year. And that should provide extra tanker demand. So, as I said, we – in the prepared remarks, we, do feel that the fundamentals on the demand-side will improve. And we

haven't seen that, kind of, IMO 2020 bump yet either which we think will still come in the second half of the year because refineries will have to start going at fairly high utilization levels in order to produce sufficient low-sulfur diesel.

With regards to your second point on the order book. Yes, what I think, what we've had is, kind of, a year of two halves. So, the first half was definitely a very high fleet growth with all of the order book delivering in the first half of the year. And we've had very little tanker scrapping as well. And I think that's also contributing to some of the lower rates that we're seeing right now, is just – it takes time to absorb that capacity once it comes into the fleet. But, the good news is looking forward is that for the next two years, the shipyards are booked up for the next two years. The tanker order book is very low as you pointed out. We would also expect a bit more scrapping to emerge. I think it's unrealistic to think that there's going to be no ships scrapped at all. Some ships, as they go through fourth special, the owners will decide, probably, to take those ships out. And, as a result, we've seen fleet growth over the next couple of years is going to be 2% per year for the next two years. That again, it should facilitate tanker market recovery.

John Chappell: Okay, great. Thanks for the thoughts, Christian. Thanks, Kevin.

Kevin Mackay: Thanks, John.

Operator: Thank you. We'll take our next question from Randy Giveans of Jefferies.

Randy Giveans: Hi there, gentlemen, how are you?

Kevin Mackay: Good, thanks, Randy.

Randy Giveans: Hey sotwo quick questions from me. You mentioned that debt repayments, obviously, will support the share price, so how do you, kind of, prioritize this in terms of use of free cash going forward

relative to vessel acquisitions or share re-purchases? I know dividends are, kind of, a – maybe 20/20 story, but in the interim, is debt pay down, like, 100% use of free cash going forward?

Stewart Andrade: Hi, Randy. For 2019, debt repayments will be our focus. And I think as we repay some of that incremental debt that we took on in some of our liquidity initiatives of the last two years, moving into 2020, we have more flexibility with our capital allocation. And I think then, we'll look for – we'll look at different opportunities to allocate that depending on where our shares are trading and what we see as our dividend capacity at that time. So, I think into 2020, we'll start to look at different options aside from dividend – pardon me, aside from debt repayments.

Randy Giveans: Okay. And then, kind of looking at your fleet, you have, maybe, I don't know, 10 to 12 vessels or so, over 15 years of age. Are you thinking of possibly selling some of those to further accelerate that strategy of delevering the balance sheet?

Kevin Mackay: Yes, I think, obviously, I think I answered this on the previous quarter – we don't want to be selling tankers at the bottom of the market but certainly, as the market picks up and asset values start to increase, we will be looking at our fleet composition, and looking to take advantage of the higher asset prices by selling off some of those units that don't fit the portfolio. It's part of the strategy.

Randy Giveans: And then one specific question for your IMO strategy. Obviously, no scrubbers on order, do you plan on burning MGO next year, or you switch to some of the VLSFO blends despite some possible compatibility concerns? And then with that, when you plan on cleaning out your tanks to switch from your, kind of, current HSFO to that MGO or VLSFO?

Kevin Mackay: That's a good question. We, over the last, really, two years have really been gearing up to face this IMO implementation on January 1st. So, I think in terms of what kind of fuel we burn, we purchased fuel in 70 different locations around the world last year. So, we've really had to approach this with flexibility of mind. So – what we're looking to do is stem both the low sulfur products that are out there as – well,

sorry, the low sulfur fuel oils that are out there as well as MGO, depending on the availability in various locations. We've made tank modifications to accommodate that; and also in our bunker supply contracting, we're looking to make sure that we have access to both grades. In terms of the compatibility on the low sulfur fuels, that's where the tank modifications have come in. And we're fairly comfortable now in terms of our readiness to adopt those new fuel types without affecting the operation of the ships.

Sorry, what was the second half – part of your question?

Randy Giveans: Just, kind of, the timing of cleaning out your tanks to switch from HSFO to the VLSFO or the new fuel?

Kevin Mackay: Yes, it will depend on the class of ship. Obviously, with Suezmax's running on much longer voyages, we're going to have to start to put on the lower sulfur grades earlier than, maybe, the Aframax's, that we can push closer towards the back end of the year. But you're probably looking at stemming the bunkers in the late Q3 – early Q4 period as a start for those ships that are doing long West Africa, or US Gulf to China runs.

Randy Giveans: Sure. Great. Thanks for the color.

Kevin Mackay: Okay, thanks, Randy.

Operator: Thank you. We'll take our next question from Ken Hoexter[?] of Bank of America.

Ken Hoexter: Great. Good afternoon, Kevin and Christian and Stewart. I just wanted to follow up – I guess, a real quick one on the time charters-in that are expiring. Should we just presume you're releasing those vessels and shrinking the fleet as we move through the rest of this year as well?

Kevin Mackay: We tend to look at our time charter-in portfolio opportunistically. So, if the owners of those ships are willing to extend at reasonable levels where we think we think we can make a margin, we'll certainly entertain that; and not necessarily just default to a release of the vessel because of the expiry. We're always looking for opportunities and if we've got a good relationship with a good operating vessel, we obviously start having talks with the owners prior to the end of the charters. But if we can't come to terms that we think are economically advantageous to us, then, yes, certainly you'll see those ships roll-off.

Ken Hoexter: Okay. Helpful. And then, maybe, just your thoughts on timing for the scrubbing benefit to pricing. Obviously, you know that vessels are going to start getting laid up for the installation on the market. I know you've got no plans, you said. But, when do you start to see that? Is that, kind of, more third quarter, fourth quarter, timing, or do you not think it really hits until the demand for new fuel into the beginning of 2020?

Kevin Mackay: Well, I think we certainly haven't seen a lot of vessels been taken out so far this year which I think speaks to some of our enthusiasm for where the market will start to pick up later in the year because most owners that we have spoken to have indicated that they will have the scrubbers on board and ready for 1st January. So, there's an awful lot of ships that need to go into dry dock across the VLCC, Suezmax, Aframax fleets. So, you could see a significant impact in the 2% range of fleet supply that gets taken out between now and Christmas in order for those scrubbers to get fitted, which would certainly help the supply-demand balance that we're looking at.

Ken Hoexter: Is there enough yard capacity from your view to get that done?

Kevin Makay: I think the yard capacity is, certainly, tightening. We, as you can see on our supporting documentation, have had a fairly busy dry docking year this year. And although, the early part of the year, dry docks – securing dry dock capacities has been relatively easy. I think it's going to get more challenging as we get into the later part of the year. So, we've, sort of, front-run that and made sure

through our relationships and our contracts with the yards that we are confident our ships are going to get in.

Ken Hoexter: Helpful. And just the last one for Kevin or Christian. But where does your outline go wrong? I guess, when you think about the excess supply that's still out there – I think John was talking about this earlier, but given the lack of retirement, what do you view as shifting – what could shift that, I guess, positive rate inflection that you anticipate?

Kevin Mackay: I don't think you can really speak to one thing that's going to drive it one way or the other. I think, historically, the tanker market, it's always been a combination of events or of headwinds or of tailwinds that have either boosted or dragged on the market. As Christian pointed out in his previous answer, I think we've got refining margins that are improving. You've got IMO demand that needs to kick in. There's a lot of positive factors that are going to contribute but certainly, if owners decide not to scrap and try and trade a vessel into its 21st, 22nd years, then that could adjust the balance.

And I think that's why you've seen us in our presentation, look at both the positives and the negatives and re-look at our utilization figures and adjusted them slightly downwards. But I think we still are confident that the way the majority of drivers in the industry are moving, utilization rates should pick up as we move through this year and into next year. And that should be positive for rates.

Ken Hoexter: Great, appreciate the time. Thank, Kevin.

Kevin Mackay: Thanks, Ken.

Operator: Thank you. At this time, we have no further questions. I'll turn it back to Kevin Mckay for closing remarks.

Kevin Mackay: Thank you for joining us today, and we look forward to seeing you in October at our Investor Day.

Thank you very much.

Operator: Thank you, ladies and gentlemen. This concludes today's conference. You may now disconnect.