TEEKAY TANKERS LTD.'S SECOND QUARTER 2021 EARNINGS RESULTS CONFERENCE CALL

Company: Teekay Tankers

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Conference Time: 12:00 ET

Operator: Welcome to the Teekay Tankers Ltd.'s second quarter 2021 earnings results conference call. During the call all participants will be in the 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 the company. Please go ahead.

Speaker: Before we begin, I'd like to direct all participants to our website at www.Teekaytankers.com, where you'll find a copy of the second quarter 2021 earnings presentation. Kevin and Stewart 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 of 2021 earnings release and our next presentation available on our website. I'll now turn the call over to Kevin MacKay, Teekay Tankers president CEO, to begin.

Kevin MacKay: Thank you, Ryan. Hello everyone. Thank you very much for joining us today for Teekay Tanker's second quarter 2021 earnings conference call. I hope that you and your families are all safe and healthy. Joining me on the call today are Stewart Andrade, Teekay Tanker's CFO, and Christian Waldegrave director of research for Teekay Tankers.

Moving to our recent highlights on slide three of the presentation, Teekay Tankers had negative total adjusted EBITDA of $6.8 million during the second quarter down from $15.9 million in the prior quarter. We also reported an adjusted net loss of approximately $42 million or one dollar and 23 cents per share during the second quarter, compared to an adjusted net loss of $22 million or 65 cents per share last quarter. Our results are largely due to weak spot Tanker rates, a heavy drydock schedule period during the quarter and the exploration of fixed rate time charter-out contracts secured during the strong tanker market last year.

Despite a challenging quarter, we continue to have a strong balance sheet with proforma liquidity of $274 million, and a net debt to capitalization of 36% at the end of the second quarter. In addition, as previously announced, we are in the process of lowering our cost of capital by refinancing vessels that have been in higher cost sale leaseback structures, which Stewart will elaborate on later in the presentation.

Lastly, spot tanker rates continue to be very weak in the second quarter due to the ongoing impact of COVID-19 and this weakness has continued into the early part of Q3. Looking ahead, although the near-term outlook is uncertain due to COVID-19, we believe many key indicators for a tanker market recovery continue to improve, which I will touch on in more detail later in the presentation. Based on our forward view, we counter-cyclically in-chartered three additional Aframaxes for 18 to 24 months with options to extend beyond firm periods.

Turning slide four, we look at recent developments in spot tanker market. Spot tanker rates remain very weak in the second quarter, primarily due to the ongoing impact of COVID-19 on oil demand and associated oil supply cuts from the OPEC+ group.

There were also a number of short-term factors, which negatively impacted rates during the quarter. Although OPEC+ started increasing oil supply from May onwards, this didn't translate fully into additional crude exports as Saudi Arabia increased the domestic consumption of oil for power generation during the summer months. We also saw a decline in long haul oil movements from the Atlantic to Pacific during the quarter due to widening of the Brent-Dubai oil price spread. This meant a drop in average voyage distances, which was negative for tanker tonne-mile demand. Lackluster Chinese crude oil imports were also a negative, with imports down 3% year-over-year in the first half of 2021. This was due to a combination of reduced product export quotas for independent Chinese refiners, new taxes on bitumen and other feedstocks, and inventory drawdowns due to higher oil prices.

The first half of the year also saw significant growth in available fleet supply due to the return of ships from floating storage and a front-heavy order book delivery schedule. Using the Suezmax sector as an example, 20 of the 22 newbuildings scheduled for delivery this year have already entered the fleet. The flip side of this is the second half of the year will see a much lower delivery schedule and therefore relatively low fleet growth compared to the first half.

Finally, higher bunker prices have negatively impacted on tanker earnings in recent months. Prices have increased by approximately a hundred dollars per ton since the start of the year, which is equivalent to a reduction in spot rates, approximately three to $4,000 per day.

The weak spot tanker market has also weighed on time charter rates. As shown by the chart on the right of the slide. Although the near-term outlook remains challenging, we believe there will be a stronger freight market over the next two to three years and we have therefore taken the opportunity to counter-cyclically in-charter three additional Aframaxes for periods of between 18 to 24 months at an average rate of $17,800 per day with extension options, which we believe represents an attractive risk-reward and has been a profitable lever for us during past tanker market cycles. These vessels will deliver over a staggered period from mid-Q3 through the end of Q4.

Turning to slide five, we provide a summary of our spot rates in the third quarter to date. Based on approximately 41% spot revenue days booked, Teekay Tankers third quarter to-date Suezmax bookings have averaged approximately $2,400 per day. These lower averages are partially the result of the timing of repositioning voyages for unfixed vessels, which have incurred bunker fuel expenses in the near term without offsetting charter revenue, which will be recorded later in the quarter when the vessels are fully fixed.Current

Suezmax round trip TCE returns are averaging $5,600 per day per the latest Clarkson's spot rates being reported.

For Aframax and LR2 fleets, which are predominantly trading dirty based on approximately 36% and 38% spot revenue days booked. Third quarter to-date bookings have averaged approximately $6,200 per day and $8,100 per day respectively.

Lastly, in anticipation of an improved winter market, we will complete ten of our scheduled 12 drydockings, by the end of the third quarter.

Turning to slide six, we look at some of the key indicators, which we believe point towards a tanker market recovery, and which have continued to improve over the past quarter. While oil demand continues to recover in tandem with the roll out of global COVID-19 vaccinations, particularly in North America and Europe, where we're seeing a significant recovery in transportation fuel demand during the summer months. We expect oil demand will continue to recover through the second half of the year and to revert back to pre COVID levels sometime in 2022. However, we also acknowledge that recovery will be uneven across different regions, and that COVID-19 may continue to periodically disrupt demand as new outbreaks emerge and fresh travel and mobility restrictions are implemented.

A combination of recovering oil demand and OPEC+ supply cuts has significantly reduced bloated oil industries, which are now well below five-year averages and which have pushed oil prices above $75 per barrel in recent weeks. The OPEC+ group has recognized that the world needs more oil in order to keep the markets at balance and has announced the production increase of two million barrels per day between August and December. Although they plan to review their policy in their December meeting, the group has also indicated they intend to fully unwind their supply cuts by September of 2022. This boost to production coupled with an expected increase in non-OPEC supply should be positive for tanker demand in the coming quarters.

The fleet supply side continues to look very positive. In particular, we would highlight the acceleration of tanker scrapping over the past few months due to a combination of weak freight rates and very high scrap prices, which are currently at a ten year high. A total of 6.6 million deadweight tons have been removed from the fleet so far in 2021 compared to just 3.5 million deadweight tons in all of 2020. The combination of a relatively small tanker order book, low levels of new tanker orders choose a high and newbuilding prices, and an increased in scrapping are expected to keep tanker fleet growth and relatively low levels over the next two to three years.

In summary, although tanker rates have been at historical low levels through the first half of the year, we believe that the market may be nearing an inflection point through a combination of rising tanker demand and constrained fleet supply. It appears that the sentiment is shared by the wider market as asset values have risen by over 20% since we started the year in anticipation of a stronger tanker market in the coming quarters and years. I'll now turn the call over to Stewart to cover the financial slide.

Steward Andrade: Thanks, Kevin. Turning to slide seven, we highlight the company's strong financial foundation. As Kevin mentioned in his opening remarks, we continue to have a strong balance sheet which provides us financial strength and flexibility. We have a proforma liquidity position of $274 million and the net debt to capitalization of 36% at the end of the quarter.

Since November 2020, the company has declared options to repurchase eight vessels that were under a higher cost long term sale-leaseback financings. In May, two of these vessels were repurchased for $57 million using existing liquidity and thus remain unencumbered while the remaining six vessels are scheduled to deliver in September for $129 million. We have signed term sheets and are in the documentation stage to refinance all eight vessels with lower cost sale leasebacks for a total refinancing amount of $142 million, which we expect to close in the third quarter. As mentioned in prior presentations, one of our strategic priorities is to reduce our cost of capital and this refinancing will result in an estimated interest expense savings of approximately $11 million in the first 12 months.

Lastly, having reduced significant amounts of debt in 2020, our debt repayment profile is very manageable in the coming years with no significant debt maturities until 2024. With that, I will turn the call over to Kevin to conclude

Kevin MacKay: Thanks Stewart. As I've said in past quarters, I would again like to thank all of our seafarers on shore-based staff for their continued dedication to providing safe and uninterrupted service to our customers during these challenging times. We continue to focus on the safety and wellbeing of our seafarers. As we look forward to the continued transition to a more normalized world, the strong financial position and high operating leverage, we believe that Teekay Tankers is well positioned to continue to weather the current market challenges and benefit from an anticipated tanker market recovery in the quarters ahead. 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 are using a speaker phone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again, that's star one to ask a question. We'll pause for just a moment to allow everyone an opportunity to signal for questions. And we'll go first to John Chappell with Evercore ISI.

John Chappell: Thank you. Good morning, good afternoon. Kevin, first question, you mentioned the secondhand values are up 20% and it seems like the disconnect between, asset values and the actual market itself is widening almost by the week and you guys have a pretty diverse fleet as it relates to age. So it's almost like the market's kind of giving you a gift, and I understand you want to keep your operating leverage given your view on the market, but whether it's scrapping or selling, maybe some ships that are a little bit less core than the more modern ones. Have you thought about taking advantage of that opportunity and monetizing some of your ships in a market that's kind of still really difficult?

Kevin MacKay: Yeah, it's a good question John, I think we've said in the past we're open-minded in terms of how we approach our sales strategy on some of the older units. So if the right opportunity comes up at the right price, it's something that we will definitely consider. But at the moment although asset prices are up, the activity levels have dropped off in the last couple of months. So, as of now we haven't really seen anything that we can conclude on, but it's certainly something that we keep an eye on.

John Chappell: Okay. And Stewart, I kind of asked the sale leaseback every quarter I feel, but maybe I'll just ask it a different way this time. If this lasts longer than most of us think and you've certainly laid out, a thesis on the recovery in the market, that's in line with ours, but it's also continuing to be pushed to the right a little bit, how many unencumbered vessels do you have? What's your opportunity to maybe refinance some other vessels, just other liquidity triggers that are not the obvious, sale leaseback refinancing that you've accomplished over the last year.

Steward Andrade: Hi John, so in total at the moment we have three vessels which are unencumbered, two of them that we just repurchased in May. And we intend to refinance in September, as I mentioned in the prepared remarks. Aside from that, we have one of the one other vessel, which is unencumbered at the moment. In terms of other levers to pull, as you can see from the sale leasebacks that we're currently doing there, we do have a group of lessors who are happy to work with us and that we can do higher leverage financings on if we choose to do so. So I guess the main lever I would point to is the number of vessels that we have in commercial debt financing that we could move into sale leasebacks and that market is quite diverse in terms of the loan to value you can achieve, depending on the counterparty you go with and the interest rate you're willing to or think is prudent to pay. So I think we still do have a fair amount of head room there. As you mentioned, we have laid out the thesis for a market recovery and we have taken some- started taking vessels on longer-term time charter, I guess which underlies our confidence in the market improving in the sort of medium term.

John Chappell: Okay. If I can just sneak one last quick one in Kevin on the third quarter to date rates, you laid out the repositioning issues associated with the Suezmaxes. Is it similar in the Aframax? And then also, is there any way to quantify the impact of those? Because usually the numbers that publicly traded companies like yourselves put up are much better than maybe the industry benchmarks and, that's not necessarily the case, this quarter. So a little bit surprising by just how low those figures are.

Kevin MacKay: Yeah, I think, obviously we've got to acknowledge that the market is at historic lows and as a result of that, it is challenging. Perhaps more so on the Suezmax side than on the Aframaxes to keep the tonnage moving and to get the right voyages. So yeah, the differential there on the ballast portions is definitely more of a Suezmax issue than it has been on the Aframaxes. And that's really a function of the fact that the Suezmax is more of a global trading ship, and in our case, we happen to have a number of ships that were coming out of drydock in China as well as we positioned the few ships into the Asian market in the prior quarter. and we found with the lack of supply coming out of Saudi Arabia, despite their increase in production we felt that it was best to reposition ships further afield and to stretch our program out. So this quarter, we had quite a number of ships that have the ballast lag issue. So it's more confined to the Suezmax than with as anything else. In terms of quantum, I don't have the exact figure with me, but there's a couple of thousand dollars a day at least of an impact which as the quarter goes on and those ships get into position and are fixed away we'll get the revenue to offset that, and we should come up to more market-related levels than what we're posting here at this point in the third quarter.

John Chappell: Okay. That's great. Thanks, Kevin. Thanks Stewart.

Steward Andrade: Thanks John.

Kevin MacKay: Thanks John.

Operator: Ken Hoexter with Bank of America.

Ken Hoexter: Hey great, good afternoon. Can we just talk a little bit about the-Kevin there is it typical to see asset values climbing ahead of the inflection and spot rates or typically, do you see the spot rates move and then see the asset values climax? Seems like we're doing a little bit of backward, is that just the typical anticipation or is this an abnormal part of the move here?

Kevin MacKay: No, the asset values typically, we'll look at a number of factors, one being newbuilding prices, and the other one being where the forward market is likely to go as opposed to where the actual market is right now and I think both of those factors have come into play, we've seen asset prices move quite significantly in the first half of this year, driven off of a very large increase in newbuild prices, on the back of constrained supply so that has been a big driver. I think also it's sentiment driven, although the current spot market is historically weak, people are looking at the fundamentals that continue to show improvement month on month and it's a question of timing as to when the spot market catches up with where people's perception of where the asset price and the time charter price has been going. Christian, you want to give any more detail in terms of the newbuild or secondhand price increases over this last few quarters?

Christian Waldegrave: Yeah, I think it's not unusual to sometimes see the asset values move ahead of the freight market. I think the degree to which it's happened this year has been a bit unusual and I think as Kevin pointed out, it's due to various factors, some of which have nothing to do with the tanker market. So the newbuild prices have definitely rocked it up this year, and it's not really due to tanker orders, it's due to all the container ship orders getting placed and the highest steel costs. and then that kind of filters into the modern secondhand values and then at the older end of the spectrum is where we see very high scrap prices, they've been the highest since I think 2008, and then you've also had this year, a few state-owned companies that have been active in the secondhand market, and they're probably more willing to pay up and push the market there. So several factors that have driven the pricing up and as Kevin said, I figured it's also an anticipation of some better times ahead, but I would say that the degree to which they've de coupled this year has been a bit unusual.

Ken Hoexter: That's helpful. I appreciate that Christian thanks. Kind of just one follow up, the move to more Saudi local production COVID creep on kind of demands that's going on with Delta. What signs do you see for the recovery? I guess maybe I'm trying to figure out your timing thoughts. As John mentioned that keeps getting pushed out to the right. So what's your thoughts on when you see this inflection in the market rates, right just especially given the low numbers here you're talking about we're seeing in the market now.

Kevin MacKay: Yeah. I think it's going to be really difficult to capture it towards the, the exact quarter. But, as we pointed out on slide six, some of the things that we look at in terms of global oil demand relative to where it's been, inventory levels coming down, global oil production both from OPEC+ as well as non-OPEC that has started to come back, and that juxtaposed with the ever improving sort of tanker orderbook relative to fleet size picture that we're seeing fleet supply going forward. I mean, if you look at all of those, all the metrics are heading in the right direction. I think what we've highlighted in our commentary is we are having said that, going to see some regional dislocations because of COVID and you will see as this is happening right now in a few parts of Asia where, companies or cities, sorry not companies, countries or cities are going into some form of reduced mobility and restrictions on travel and things like that and we think that'll continue. But overall the macro picture, seems to be continuing to improve quarter on quarter.

Ken Hoexter: Great, appreciate that. That's good. Appreciate it.

Kevin MacKay: Thanks Ken.

Operator: Well, the next is Randy Giveans with Jeffries.

Randy Giveans : Howdy gentlemen, how's it going?

Kevin MacKay: Hey Randy.

Speaker: Hey Randy.

Randy Giveans: Two questions for me, first, you chartered in those three Aframaxes, two crude one product, for 18 to 24 months, I guess, how did this come about why these vessels in this segment and why that duration?

Kevin MacKay: Yeah. I think we've spoken about it in the past in terms of our capacity to look at expanding our spot exposure through the use of in-charters. We've done it a number of times quite successfully and it's always been incremental, or accretive to our bottom line. So we're always in the market looking at the potential to bring in ships. And at this point, looking at where spot markets are, it's obviously there's a disconnect between the time charter rate and the current spot market. So looking at short term six months, one year deals were obviously off the table. But given our conviction that over the course of the coming quarters, and certainly over the next two to three years, we do see a return of some better freight rate environment.

So timing, you can never time it perfectly. I don't think in 2013 or 2014, when we did a large in-charter program the last time, that we called it exactly right on the quarter. But the duration allows us the ability to absorb somewhat of a weaker market at the front end so that we can take advantage of what we think will be attractive rates in comparison to where spot rates are two to three years out. So it was really putting our toe in the water and starting to build our book, and then seeing what develops over the coming quarters, and we'll probably make decision whether to add to that or to continue to sit on the sidelines from here.

Randy Giveans: Okay. And then in terms of your vessels, and industry-wide, there's certainly been a subdued nature of scrapping despite low rates, high steel prices. When do you think that turns, or what causes that to turn? You have some 17 plus year old vessels, I guess, at what age you start looking at scrapping those, and then how big of a discount are those older vessels earning relative to a more modern eco build?

Kevin MacKay: Christian can probably give you a better rundown on the scrap environment right now, in terms of the way Teekay looks at our fleet, obviously we have, a couple of ships that are getting up to the 17 year, 18-year range. So, we're constantly looking at what is our forward view of the earnings on those ships versus either selling them at today's pricing or trading them out to scrap. At this point in time, we haven't made any decisions to send those ships to scrap, we still believe that this market will turn in time for those ships to be accretive but as I said to John in this question, we're also at the same time looking at the sale market, and if the right price comes along for those older ships, we'll certainly execute on them. Christian, you want to give some more color on the actual scrap macro picture?

Christian Waldegrave: Yeah, I think earlier in the scrapping was quite low as you said, Randy, I think that's probably a function of owners maybe had some deeper pockets after the good run we had at the end of 2019 and the first half of 2020. But we definitely have seen an acceleration in the last sort of three, four months. I think if we look at script scrapping year to-date, we're getting close to seven million deadweight, which has already doubled what we had last year, we had about three and a half million deadweight last year and the same in 2019. So I think the very low freight rates we're seeing now and as mentioned points out the high scrap prices are just starting to kick start a bit of that scrapping and I think that will then continue into the next couple of years, because we're starting to get into kind of the parts of the fleet age profile, where we'll see a lot of ships turning age 20, or hitting that time of 17, 18 to 20-year-old bracket over the next two, three years. And it's another reason why we're sort of more positive on the market looking ahead to next year and particularly 2023. If you look at that year on the Aframaxes, I think we've got 72 ships that you had turning age twenty. So I think this is we're kind of at the beginning of this kind of scrapping phase and that definitely has been a little bit of an uptick in the last two or three months.

Randy Giveans: That's it for me. Thank you.

Kevin MacKay: Thanks, Randy.

Operator: Well, then next we have Magnus Fyhr with H.C. Wainwright.

Magnus Fyhr: Yeah. Thank you. Good afternoon. Just a follow up question on these chartered-in vessels, I mean the rates have been pretty flat in three years. Have you seen much changes on the two year rates or did you feel like you got a really- I mean the rates here has it changed at all in the last couple of months as you've been looking at these opportunities?

Kevin MacKay: Yeah. Hi Magnus, we did actually we have seen some movement on the two-year coming off to the levels that, that we took the ships in on. And that was why we felt that maybe now is a time to start executing. The three-year rate has held up pretty strongly, and that's why looking at our two-year deals with the options to extend for the third year that gave us the optionality to carry it through, which, we believe will be a pretty strong market at that point in time. But yeah earlier in the year when asset prices were up higher, there was maybe a bit more conviction in the time charter market that the second half would kick off in earnest in June. We saw the two-year rate certainly higher than where it is today. And that was why when it came off I think we did the first ship at the end of Q2 and then early in July, we pulled the trigger on the next two. So yeah, it's come off a little bit. It could potentially come off further if the spot market doesn't improve in the coming weeks. But there's also not that much activity and it's fairly quiet, across the market.

Magnus Fyhr: Right. So I guess this is kind of one-off deal, but do you think there's what's the you said the liquidity is quite low, but you think there's appetite to do more of these charters? I mean from the other side?

Kevin MacKay: Appetite from ship owners to give us ships you mean or?

Magnus Fyhr: Right. At these levels, I mean, could you do more if you wanted?

Kevin MacKay: I think we probably could certainly, we were looking at another one and we decided not to not to pull the trigger. From our standpoint, as I said we in the past, we've built up quite a large in-charter portfolio and you know, going into a stronger market, you may see us do more or be a bit more active, in terms of building up some scale. But I don't think we should be pulling the trigger all at one time. We felt that doing one or two, ended up doing three at this point. As I said, the market, if the spot market continues to be weak for the coming weeks, you may see the numbers come off a little bit more. We'll reassess our forward view and what pricing we're seeing and we may take some more, or we may as I said, sit on the sideline and wait until the green shoots in the spot market actually start to bear some greener color and maybe then we'll go back in and do some more. But it's something that we constantly look at on a daily basis and I don't think we're going to get the timing perfect, but it's certainly something that going into a stronger market, it's an area or a lever that we have pulled in the past. I think we can certainly pull again with more than just the three ships.

Magnus Fyhr: Great. So thanks for the additional color.

Kevin MacKay: Thanks Magnus.

Operator: And at this time there are no further questions. I will turn the call back to the company for closing remarks.

Kevin MacKay: Stay safe, and we look forward to speaking with everyone in three months' time. Thank you.

Operator: This does conclude today's conference. We thank you for your participation.