TEEKAY TANKERS LTD.'S FIRST QUARTER 2022 EARNINGS RESULTS CONFERENCE CALL

Company: Teekay Tankers Ltd

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Operator: Good day, ladies and gentlemen. Welcome to the Teekay Tankers Ltd.'s first quarter 2022 earnings results conference call. During the call all participants will be in a listen-only mode. Afterwards you'll 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 questions. For assistance during the call please press star zero on your touch-tone telephone. Thank you.

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.

Christian Waldegrave: Before we begin, I would like to direct all participants to our website at www.teekaytankers.com, where you will find a copy of the first quarter 2022 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 first quarter 2022 earnings release and earnings presentation available on our website. I will now turn the call over to Kevin Mackay, Teekay Tankers' President and CEO, to begin.

Kevin Mackay: Thank you, Christian. Hello everyone and thank you very much for joining us today for Teekay Tankers first quarter 2022 earnings conference call. Joining me on the call today are Stewart Andrade, Teekay Tankers' CFO, and Christian Waldegrave, our Director of Research.

Moving to our recent highlights on Slide 3 of the presentation, Teekay Tankers generated total adjusted EBITDA of approximately $17.5 million in the first quarter of 2022, an increase from $9.7 million in the fourth quarter of 2021. We reported an adjusted net loss of $14 million or $0.41 per share during the first quarter, an improvement from an adjusted net loss of $25 million or $0.74 per share in the prior quarter. Our results improved quarter-over-quarter were primarily due to higher spot tanker rates.

We have maintained a focus on financial strength, supported by our recent attractive refinancings and vessel sales that have taken advantage of the firm asset market, as Stewart will discuss later in the presentation.

In the freight market, after a slow start to the year, we saw a notable spike in spot tanker rates late in the first quarter, driven primarily by the impact of the Russia-Ukraine conflict. The increase was most pronounced in the midsize tanker segment in which we operate, given disruptions to oil trading patterns, which increased tonne-mile demand. Rates continued to rally into the second quarter with nearly all of our vessels trading in the spot market. We are well positioned to generate strong cash flow in a strengthening market.

Finally, as part of ongoing fleet management, in 2022, we have completed the sale of three vessels built in 2004 and 2005 for approximately $44 million. This includes one 2005-built Aframax sold for approximately $15 million and two vessel sales that were previously announced.

Turning to Slide 4, we look at recent developments in the spot tanker market.

Spot tanker rates were relatively weak during the first two months of the year due to a number of factors. These included the ongoing impact of the Omicron COVID-19 variant on oil demand, lower-than-expected oil supply growth due to temporary production outages, and a continued drawdown in global oil inventories. Further, high oil prices which led to an increase in bunker costs, also impacted tanker earnings in the quarter.

However, Russia's invasion of Ukraine in late February led to an increase in tanker rates, particularly in the Aframax and Suezmax sectors due to trade disruptions and the rerouting of cargoes. I will give more detail on the impact of Russia's invasion of Ukraine on the tanker market later in the presentation. As you can see on the right side of this slide, since late February, the Aframax and Suezmax sectors had exhibited significant rate volatility with rates averaging well above the depressed levels seen earlier in the year and throughout 2021. We expect this volatility to be an ongoing feature of the market in the near term.

Turning to Slide 5, we provide a summary of our spot rates in the second quarter to-date.

In the second quarter, based on approximately 52% and 45% of spot revenue days booked, Teekay Tankers' second quarter to-date Suezmax and Aframax bookings have averaged approximately $27,400 per day and $30,900 per day, respectively. For our LR2 fleet, based on approximately 43% of spot revenue days booked, second quarter to-date bookings have averaged approximately $30,400 per day.

I would note here that the Aframaxes have been significantly outperforming the larger tankers in the strengthening market with LR2s very recently surging to very high levels after a relatively muted performance in the early part of second quarter.

Turning to Slide 6, we look at the near-term outlook for midsize tanker demand following Russia's invasion of Ukraine in late February.

Conflict in Ukraine has led to a significant shift in crude oil trading patterns as many countries in the West look to reduce their purchases of Russian oil. As shown by the chart on the left of this slide, Russian crude oil exports out of the Baltic and Black Sea have remained relatively steady since the invasion. However, there has been a decrease in short-haul crude oil exports to Europe and a corresponding increase in both the volume and proportion of oil heading to destinations east of Suez, most notably to India. At the same time, Europe has had to replace Russian crude oil with imports from further afield, including the US Gulf, West Africa and the Middle East. As shown by the chart on the right of this slide, crude oil exports from the

US Gulf to Europe at the end of April with the highest since March 2020, with the vast majority being moved on Aframaxes and Suezmaxes. Due to the nature of the load regions involved and the need for greater flexibility in discharge options, midsize tankers have benefited more significantly from these changing trade patterns compared to VLCCs where rates have remained relatively weak.

The net impact of these changes has been a lengthening in average voyage distances and therefore higher tonne-mile demand. Given the European Union's recent proposal to phase out all Russian crude oil imports over the next six months and refined products by the end of 2022, we expect that these altered trade patterns may persist over an extended period of time. In addition, the fleet of Russian owned and operated ships, which comprises approximately 5% of the global Aframax fleet is finding it harder to trade, which further tightens available fleet supply in this segment.

Turning to Slide 7, we look at fleet supply fundamentals, which we believe are the most positive scene in the last two decades.

Rising newbuild prices, which are currently the highest since 2009 and a lack of shipyard capacity continue to limit new tanker orders with just 0.2 million deadweight tons of new orders placed in the first quarter of this year, the lowest since at least 1996. As you can see from the top two charts on this slide, there are very few tankers on order for delivery past 2023 and with the most major shipyards being full through the middle of 2025, there is limited available capacity to order new tankers for delivery in the next three years. The tanker orderbook, when measured as a percentage of the existing fleet stands at just 6.4%, which is the lowest since Clarksons started recording orderbook data in 1996. Finally, the tanker fleet continues to age. A large number of vessels are set to reach age 20 in the next few years with a significant number likely to be phased out.

The combination of a small tanker order book, low levels of new tanker ordering and a lack of shipyard capacity until late 2025, and an aging fleet should lead to very low levels of tanker fleet growth over the next two to three years. Our current forecast is for around 2% tanker fleet growth in 2022, followed by zero growth in 2023 and potentially negative fleet growth in 2024 and 2025, when ship removals are expected to exceed new tanker deliveries.

To sum up, spot tanker rates have increased following Russia's invasion of Ukraine and look to remain volatile in the coming weeks and months as the situation continues to unfold. Although the near-term outlook is uncertain, the longer-term outlook appears very positive due to an anticipated period of very low fleet growth, which should support stronger tanker rates.

I'll now turn the call over to Stewart to cover the financial slide.

Stewart Andrade: Thanks, Kevin. Turning to Slide 8, we highlight the company's healthy financial foundation.

In March and April, we completed our previously announced low-cost sale-leaseback refinancings of 13 vessels and during the year, we have also completed the sale of three 2004 through 2005 built vessels, taking advantage of firm asset prices.

Including the increase in liquidity from these transactions, our pro forma liquidity as of March 31st was $231 million. Importantly, the sale-leaseback refinancings also include purchase options that we can exercise throughout the lease terms, in some cases, starting at inception and in other cases, after two years. As mentioned when we originally announced these transactions, we secured attractive terms on these new sale-leasebacks as compared to those of the expensive sale-leasebacks we were able to unwind last year. This reflects Teekay Tankers' stronger financial position as well as the strength of the tanker market as indicated by higher asset values.

In addition to increasing our liquidity, this financing activity also extended our debt repayment profile appreciably such that we now have no significant debt maturities through 2026, while net debt to cap was 42% as of March 31st.

With 46 vessels or about 94% of the fleet trading in the spot market, Teekay Tankers has high operating leverage, and we are exceptionally well positioned to take advantage of strengthening rates to generate significant cash flow which will in turn enable us to further reduce our debt, creating value for shareholders.

With that, I will turn the call over to Kevin to conclude.

Kevin Mackay: Thanks, Stewart. Driven most notably by the war in Ukraine and the expanding number of sanctions and supply chain shifts resulting from it, midsize tankers have recently seen a return of significant rate volatility, which has driven a strong quarter to date spot performance. It's difficult to predict just how long these factors will remain so prominent in the market. But increased rate volatility is likely to continue, at least until the geopolitical tensions recede and supply chains settle into a new normal. Operating almost completely in the spot market puts us in a good position to generate significant cash flows when rates are strong, and we will continue to position our fleet to best maximize these opportunities as they arise.

Looking forward, with a very low orderbook in the coming years and minimal shipyard capacity available to change that fact before 2025, we feel quite positive about the outlook for our market and Teekay Tankers' prospects in it.

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

Operator: Thank you. Ladies and gentlemen, if you'd like to ask a question you may do so by pressing star one on your telephone keypad. Star one for questions. Please make sure the mute function on your phone is turned off so the signal can be read by our equipment. Star one for questions. We'll pause a moment to give everyone an opportunity to signal for question. We'll take our first question from Jon Chappell with Evercore ISI. Please go ahead.

Jon Chappell: Thank you. Good afternoon or good morning or good afternoon, I guess depending where you are Kevin. Stewart, starting with you, hopefully, a pretty easy one. You've done a lot of the heavy lifting on the balance sheet over the last 2.5 years, mostly through difficult periods. Based on your 2Q to date bookings and most people's views of the market going forward, you are on the verge of generating significant operating cash flow. You mentioned some of the flexibility around the leases, would finance lease pay downs still be the number one priority for uses of cash? Or do you start to pivot to something else, whether that's growth or capital returns?

Stewart Andrade: Hi, Jon. Good question. It's been a tough tanker market for the last four to six quarters and definitely our focus in the near term is going to be on paying down debt and strengthening the balance sheet further. We think, ultimately, that puts us in a position where we can take advantage of opportunities which will allow us to, over the long term, have the best returns for our shareholders. So I would expect definitely in the short term that we'll be focused on continuing to pay down debt and strengthen the balance sheet.

Jon Chappell: And still a focus on leases as opposed to bank debt?

Stewart Andrade: Going forward, I don't think that we'll be -- given the current market conditions and where we are with our liquidity levels, I don't expect that we'll be taking on or doing any more leases at the moment. We'll continue to monitor the market. In terms of refinancings going forward, I think we'll take a look at the relative balance between those two in terms of the terms we can achieve and our requirements for capital. So I think those are probably both avenues for financing that we will explore when we need to refinance things in the future but at the moment, we don't have any plans for doing anything further.

Jon Chappell: Okay, that makes sense. Second question, bit of a two-parter maybe you can pull in Christian and Kevin. Obviously, the Afras have done incredibly well. Suez have done well relative to VLCCs but the product tanker market has been just consistently outperforming the crude market and these diesel shortages that are going from problems to potentially really dangerous don't seem to have a near-term remedy. Christian, can you maybe talk about the impact that the diesel dislocation is having on the broader markets and most directly to you in terms of your LR2s and Afras? And then, Kevin, any aspirations or plans to take some of your LR2s and clean them up because maybe there's a longer tail to some of these diesel issues?

Christian Waldegrave: Yes. Hi, John. As you said, I think the situation in the products market is obviously very tight right now, especially on the diesel side, inventories are extremely low. You'll have seen the margins are at record highs, and that's kind of a result of a couple of factors.

One is that demand has recovered quite a bit since the start of the pandemic, especially for diesel and as I said, inventories have been drawn down quite low. There's a bit of a regional mismatch in that as well, and that in the Western Hemisphere, the refineries are operating at very high throughput, and that's been probably exacerbated a little bit by the fact that in the last couple of years, we've seen some refinery closures in the Atlantic, predominantly in Europe. So now the demand has come back, those refineries are having to work really hard to meet demand. There's a little bit more spare capacity in the East, so probably going forward, we would look toward Asia and India and the Middle East to supply the volumes into the Atlantic market. And I think that's what's really driven the tonne-miles, in terms of the products having to move much longer-haul, particularly on the diesel side into the Atlantic.

And then we're obviously getting toward summer now, so it's going to be the travel season, and I think with coming out of the pandemic, there's lots of parts of the world where the restrictions have been lifted. So now you're starting to see the gasoline margins increase as well and jet fuel as well. So I think the whole product side is going to be very tight going forward. Refinery throughput is going to have to increase where it can to meet that demand, and that's going to continue to drive the demand for product tankers and in particular, the LR2s. So it does look like there's going to be some legs on the product side there.

I'll hand it over to Kevin maybe to talk about our plans on the LR2s and what we're doing with the fleet there.

Kevin Mackay: Yes. It's a really good question, Jon, and something that the chartering team and I have been looking at in the last week or two. At the moment, we have two ships that are fully dedicated to clean. And at the moment, the bulk of the other LR2s that are trading dirty happens to be in the Atlantic, which really isn't a prime position to convert. It's much easier to pick up condensate crudes in Asia to facilitate that changeover from crude to clean without having to incur some additional costs for chemical washing and things like that.

The one thing we don't want to do is chase markets. So we've got to balance positioning ships into the Far East to get cleaned up and if other LR2 owners are thinking the same way, we could be missing out an opportunity on the crude side in the Atlantic. It's something we are looking at. If we can get the right combination of cargoes to do it swiftly, I think you'll probably see us clean up another few ships. But it has to be that balance between which market do you think is going to sustain, and how long does it take you to get into that market fully. So it's something that we're actively working on daily now.

Jon Chappell: Okay. Very thoughtful. Thanks. Kevin, Stewart, and Christian.

Operator: We'll take our next question from Magnus Fyhr with H.C. Wainwright. Please go ahead.

Magnus Fyhr: Yes. Hi. You just answered my questions on the clean versus dirty. But with exposure to both to Suezmaxes and Aframaxes, do you have a preference in either segment there? Or I mean, where are you most bullish now as far as the crude side?

Kevin Mackay: If you look at the way the markets have performed over the last few weeks, obviously, the Aframax spiked very well and has held its ground in the Far East as well as in parts of Europe, less so in the US Gulf and Trans-Atlantic. Suezmaxes have been less resilient, if you will, and despite what we saw has come off across most of the regions that the Suezmaxes are in currently. So our preference today, based on return, is obviously Aframaxes.

But I think we're seeing so much dislocation and disruption to trade patterns that it's really hard to call how these spikes and this volatility is going to play out between the two segments over the coming weeks. I think it's too early to dive in and say Aframaxes are going to outperform because as we know, when Suezmaxes do take off, they tend to go -- tend to spike higher. I think we've got good coverage in both segments and at this point, it's just making sure that we position both of our fleets, Aframax, Suezmax, and if we convert to LR2s, to try and maximize our revenue generation from whatever spikes the market offers us.

Magnus Fyhr: Okay. And do you see any changes from your clients, traders about securing ships for the second half of the year? How are they looking at the market currently?

Kevin Mackay: Yes, the short-term three, six, 12-month time charter market has definitely picked up in terms of customer interest levels. Certainly, on the clean side, LR2s are somewhat of a hot commodity at the moment. But again, it's more of that shorter-term period that they're talking about at the moment. We haven't seen anybody stretch out yet in terms of midterm, two, three-year type deals. But certainly, inquiry across all the segments has picked up in the last couple of weeks.

Magnus Fyhr: Okay. And given that the short-term charters really don't give you any protection or not much protection, would you have to wait to see those kind of two, three-year charters developing before you look into securing some ships?

Kevin Mackay: I think our view as market, Magnus, we believe that volatility is here for a while, caused by the disruptions with Russia's invasion. I think longer term, we're positive on the market given where fleet supply is so I don't think you'll see us rush to lock in midterm, longer-term charters. I think we're positioning the fleet to be more fully exposed to the spot market and I think we want to try and enjoy some of the volatility and maximize our earnings through that route before we start thinking about locking in at this point.

Magnus Fyhr: Good. That’s what I wanted to hear. Thank you.

Kevin Mackay: Thanks.

Operator: We'll take our next question from Ken Hoexter with Bank of America. Please go ahead.

Ken Hoexter: Great. Good morning, Kevin, Stewart and Christian. So, just -- I guess just looking at earnings all the way down to the bottom line, right, six negative quarters of earnings, but you posted positive EBITDA. What's your breakeven now? And maybe just an update on the cost side of the equation. Obviously, you gave us your thoughts on what's going on market rates, but maybe just your thoughts on costs.

Stewart Andrade: So take the first part of the question.

Kevin Mackay: Stewart, you want to go grab that?

Stewart Andrade: Yes. So Ken, taking the first part of your question, our free cash flow breakeven, including dry docking is about $15,000 per day. So as long as we're about $15,000 a day on average through the fleet, then we're in a position where we're able to pay down debt.

I'm sorry, could you repeat the second part of your question, please?

Ken Hoexter: Yes. Just -- well, the breakeven was the first one and the second one was just maybe your thoughts on cost, right? So whether it's vessel OpEx or your thoughts on the cost side, just so we can think about if there's anything actually you can do as rates start to scale here.

Stewart Andrade: Yeah. I think the cost that you've seen flowing through the income statement in the last couple of quarters and through Q1 are going to be relatively similar going forward. On OpEx, I would say that our run rate will be about $39 million a quarter, G&A in the $10.5-$11 million per quarter, and the interest in that sort of low $7 million range. So we're not expecting anything materially different through the remainder of the year on that front.

Ken Hoexter: Helpful. And Kevin, just to clarify, you said earlier, you still want to stay spot. You're not at rates yet where you want to start rolling in and locking in charters, right? I just want to make sure I caught your thought process there.

Kevin Mackay: That's correct. Yes.

Ken Hoexter: Okay. And then do you think -- you've done some sales in the past. Your thoughts on any additional sales with -- as spot rates? Is there a certain level? Is there maybe recognition of value that the market is not recognizing with where valuation is today that you'd say, okay, well, I could do that if it makes more sense for the equity holders to show them where the market values are?

Kevin Mackay: I think we look at sale and purchase deals on a stand-alone basis and each deal is determined in terms of what's the best value we can generate for shareholders. So obviously, asset prices are high, and you've seen us take advantage of that selling some of the older ships that we had that were due for dry docking. We've eliminated that expense and monetized those assets.

For what we've got left in the fleet, I think at the moment, given the volatility that we anticipate over the next few months, we certainly want to try and keep ourselves exposed to that. So we're not actively looking to sell any additional ships at this point. But we always keep an eye on where asset values are going relative to where we think the forward spot curve is going to be, and we make those decisions as and when we see value to be generated.

Ken Hoexter: Yeah. And you talked earlier about -- my last one, just on the Russia, Ukraine shifting impacts of length of hauls. Is there -- given your history, is there a -- I guess, is this just -- once this comes to a conclusion, how quickly things normalize based on your history? Or obviously, it depends on what the world looks like. What's your thought on historical look at length of impact to rates?

Kevin Mackay: I don't think anybody can predict how long this is going to take or what the other side of this is going to look like. I'll leave that to greater minds than mine. We just have to keep looking at how things are changing day by day and adapting our trading fleet to maximize our revenue stream as and when opportunities arise.

Ken Hoexter: Appreciate that. Thanks, Kevin. Thanks, Stewart.

Kevin Mackay: Thanks, Ken.

Stewart Andrade: Thanks, Ken.

Operator: We'll take our next question from Chris Robertson with Jefferies. Please go ahead.

Chris Robertson: Hey. Good morning, and thanks for taking my questions.

Kevin Mackay: Hey, Chris.

Stewart Andrade: Morning.

Chris Robertson: Just to follow up on Ken's questions related to OpEx and expenses. Can you talk about what, if any, cost pressures you are seeing this year, especially as it relates to rising oil prices and crew transfers?

Stewart Andrade: Yes. So certainly, there are inflationary pressures, which are coming to bear for everybody in all industries and all companies. Currently, we haven't seen those really flow through into our OpEx expenses in any material way. We'll have to continue to monitor that and see how things change.

As you've mentioned transportation, which certainly could end up increasing cost to some extent, depending on how inflation goes. And then over the long term, obviously, we have crew wages, which are our the most significant portion of our OpEx expenses. And that's a bit of a longer-term picture, but we'll have to see if inflationary pressures have any impact there.

But overall, in comparison to how we see the market developing over the next few years, given the outstanding supply side picture for tankers, we're quite comfortable on that front. We're not too concerned about it, but certainly, there could be some impact. But we haven't seen that start to flow through yet.

You also mentioned oil prices. Obviously, bunker prices are high, and that's flowing through not our OpEx, but our voyage economics and that is part of the picture of where our spot rates are. Obviously, we're having experiencing periods of volatility that one where we've enjoyed some much stronger rates in Q2 in our fixed to-date figures and notwithstanding the high oil prices. So hopefully, the continued volatility allows us to have good returns on that front.

Chris Robertson: Okay. Yeah, fair enough. And the higher oil prices aren't flowing through into higher lubricant costs and things like that?

Stewart Andrade: At some point, they will. A lot of our -- we have a lube oil contracts and things in place. So over time, inflationary pressures will start to come in. But if you look at lube oils, I don't have the exact percentage in front of me, but if you look at lube oils as a percentage of our overall OpEx and the impact that inflation may have on that, it wouldn't be anything material to our results, certainly.

Chris Robertson: Okay. Great. My second question, totally unrelated, but on the 13 vessels scheduled for dry docking this year, can you kind of walk us through the CapEx expense side of that?

Stewart Andrade: Sure. In Q2, we're expecting about $10 million related to both dry dock. The numbers I'll give you are both dry dock and BWTS, ballast water treatment system installations. So in Q2, expecting about $10 million. In Q3, six -- sorry, that was four vessels, $10 million. In Q3, six vessels and expecting about $12.5 million. And then in Q4, one vessel at about $3 million.

I should note that depending on the exact timing of dry docks, sometimes those dates shift around a little bit, but that's approximately what we're expecting to see overall. So about $25 million for the remaining three quarters of the year.

Chris Robertson: All right. Yeah. I appreciate that color. Thank you for the time.

Stewart Andrade: You're welcome.

Operator: At this time, we have no further questions in the queue. I would like to turn the conference back over to the company for any additional or closing remarks.

Kevin Mackay: I'd like to thank you for joining us all today and we look forward to speaking to you in three months' time at our next quarterly earnings call. Thanks for calling in.