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

Company: Teekay Tankers Ltd.

Date: Thursday, 4th August 2022

Conference Time: 11:00 ET

Operator: Welcome to the Teekay Tankers Ltd Second Quarter 2022 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 the company. Please go ahead.

Edward: 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 second quarter 2022 earnings presentation. 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 Stewart Andrade, Teekay Tankers' CFO to begin.

Stewart Andrade: Thank you, Ed. Hello, everyone, and thank you very much for joining us today for Teekay Tankers second quarter 2022 earnings conference call. Joining me on the call today are Christian Waldegrave, our

Director of Research, and Mikkel Seidelin, Director of Chartering and Freight Trading. Kevin is attending to a personal matter at the moment but sends his best. For today, I'll be leading the call. Moving to our recent highlights on slide three of the presentation, Teekay Tankers generated total adjusted EBITDA of approximately $58 million in the second quarter of 2022, an increase of approximately $41 million from the first quarter of 2022. We reported an adjusted net income of nearly $26 million or $0.76 per share during the second quarter, an improvement from an adjusted net loss of $14 million or $0.41 per share in the prior quarter. Our improved results quarter-over-quarter were primarily due to higher spot tanker rates.

In the improving tanker market environment, which I will address shortly, Teekay Tankers is benefiting from our high operating leverage with 49 vessels currently trading in the spot market. This is enabling us to strengthen our balance sheet after weathering almost two years of a weak tanker market. Both our liquidity and our balance sheet leverage are moving in the right direction and that remains a key focus for us.

Oil supply chain disruption related to Russia's invasion of Ukraine are proving to be durable with new oil supply chain now established and marked by significantly longer average voyages, particularly for midsized tankers. Volatility in the market has been pronounced and continuous, driving average rates higher. With 98% of our fleet trading in the spot market, we are well-positioned to maximize results in the strengthening tanker market environment.

At the same time, it is important to underscore that the current situation is not just a story about Russian and Ukraine or about the immediate term. The outlook for midsized tankers is positive through at least the medium-term based upon robust underlying supply and demand fundamentals.

Finally, I would point out that we entered into an agreement to sell a 2005-built Aframax in July for approximately $25 million, reflecting the recent depreciation and asset values, and allowing us to crystallize an $8 million gain. We have also in chartered in Aframax for $23,000 per day for two years, allowing us to maintain our exposure to the spot market.

Turning to slide four, we look at recent developments in the spot tanker market. As shown by the chart, spot tanker rate volatility has increased since March with rates in the second quarter of 2022 averaging significantly higher, both quarter-on-quarter and year-on-year. Encouragingly, the troughs in the tanker rates over the past few months have generally been higher than the peak seen in 2021, which indicates that the market has turned a corner and that midsize tanker fleet utilization is reaching levels not seen on a sustained basis since mid-2020.

The increase in spot tanker rates since February has been due to a combination of limited fleet growth and longer voyage distances in the mid-sized sectors due to changing trade patterns. This strength has continued into the early part of Q3 as the impact on ton mile demand following Russia's invasion of Ukraine appears to be durable. I will talk about this in more detail later in the presentation.

Turning to slide five, we provide a summary of our spot rates in the third quarter to date. In the third quarter based on approximately 43% and 37% of spot revenue days booked, Teekay Tankers' third quarter to date Suezmax and Aframax bookings have averaged approximately 29,600 per day, and 35,600 per day respectively. For our LR2 fleet, based on approximately 37% of spot revenue days booked, third quarter to date bookings have averaged approximately $35,400 per day.

The third quarter is often weaker due to seasonal factors, but thus far this quarter, the market has remained strong across our core vessel classes. To put this in context, while rates achieved in the quarter to date have meaningfully improved compared to a good second quarter, they were actually 3x to 5x higher than the rates in the third quarter of 2021.

Turning to slide six, we look at tanker ton-mile demand improvements since the start of the year. Tanker trade patterns have changed significantly since start of 2022, benefiting both Aframax and Suezmax tankers. Short haul exports of Russian crude oil to Europe have fallen by around 700,000 barrels per day compared to pre-invasion levels with Russian crude oil increasingly being diverted to destinations east of Suez, particularly to India and China, which is increasing midsize tanker tonne- mile demand.

In order to fulfill its crude oil requirements, Europe is having to replace short haul Russian barrels with imports from other regions, most notably from the US Gulf, Latin America, West Africa, and the Middle East. These changes are primarily benefiting Aframax and Suezmax tankers due to the load and discharge regions involved. These trade pattern changes are likely to be long lasting with the EU planning to phase out all Russian seaborne crude oil imports by the end of 2022.

Simply put, when oil imported into Europe, previously came five days from the Baltic, and now comes approximately 20 days from the Middle East on a Suezmax, or approximately 20 days from the US Gulf on an Aframax that is obviously helpful for tonne-mile demand. Similarly, when China imports oil from the Baltic on Aframaxes, which we've seen recently, it is another example of increased tonne-mile demand due to changing trade patterns.

Turning to slide seven, we look at the positive tanker supply and demand fundamentals over the next two to three years, which we believe point toward a more sustained tanker market recovery. Strong tanker demand growth is projected in both 2022 and 2023 due to rising oil consumption as the world adapts to the COVID-19 pandemic and a corresponding increase in oil supply, which in 2023 is primarily expected to come from growth in non-OPEC volumes. This is further supplemented by rising voyage distances due to changing trade patterns as outlined in the previous slide.

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As per estimates from Clarksons, mid-sized tanker demand is projected to grow by approximately 7% in 2022, and by further 5% in 2023, which would far outstrip projected fleet growth of around 3% and 0% in the same years.

Looking further ahead, the outlook for tanker fleet supply continues to be very positive driven by historic low levels of tanker orders, a rapidly shrinking order book, and an aging global tanker fleet.

Only 2.1 million deadweight tons of tanker orders were placed in the first half of 2022, which is the lowest total for a six-month period since at least 1996. Furthermore, most of this ordering has been for small tankers with no VLCCs or Suezmax orders placed since June 2021 and only a small number of Aframax orders placed. As a result, the orderbook as a percentage of the existing fleet has fallen to just 5.2%, which is a record low.

We expect the level of new tanker orders will remain low in the near term due to high newbuilding prices, a lack of yard space through the end of 2025 due to high levels of containership and LNG carrier orders, and continuing uncertainty over vessel technology. With the diminished orderbook and an aging fleet, we expect zero tanker fleet growth in 2023, and negative tanker fleet growth in 2024 and 2025, as removals of older ships are expected to outweigh new deliveries into the global tanker fleet.

Turning to slide eight, we highlight some of the company's key financial metrics. While the fundamentals of the tanker market have been improving for some time, the current strength in charter rates has been fairly recent following almost a two-year COVID driven market downturn. However, because of our high operating leverage with 49 vessels currently trading in the spot market, we are already generating significant cash flow in this higher rate environment.

As shown on the graph on the left, our fleet wide free cash flow breakeven level, including drydocking and other capital expenditures is less than $16,000 per day. With this breakeven and our significant operating leverage, at spot rates we booked in the second quarter, and those we have booked in the third quarter to date, our annualized free cash flow generation is substantial. In fact, at Q3 to date levels, our free cash flow yield would be on the order of 31%.

As mentioned in my earlier remarks, the company intends to use the increased cash flow to further reduce balance sheet leverage. We are already starting to make progress in that regard after two years of a weak market. Our focus is on getting our balance sheet to a very strong place that will support our business and our ability to be opportunistic throughout the tanker cycles.

In the meantime, and notwithstanding some of the macro risks in the background and the volatility that we expect to persist, we are optimistic about the mid-sized tanker market in both the short-term and in the coming years. Our mid-size fleet, spot market exposure, and trading orientation puts us in a great position to do well in a strong market. With that operator, we are now available to take questions.

Operator: Thank you. Ladies and gentlemen, once again, if you would like to ask a question, please signal by pressing star, one on your touch tone phone. If you're 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 just for a moment to assemble the queue. We take our first question from Jon Chappell with Evercore. Your line is open. Please go ahead.

Jon Chappell: Thank you. Good morning.

Stewart Andrade: Good morning, Jon.

Jon Chappell: Stewart, on that last slide you just walked through, I mean, you've been able to really deleverage the balance sheet through a very difficult market, given some of the initiatives you put in place in 2019 even before the pandemic, and now you have this accelerating free cash flow. What's the level that you want to get to, whether it's net debt to balance sheet cap or to EBITDA? How much more do you need to do based on what you see in the market today to, kind of pivot a little bit more to some of those opportunistic things you spoke about, or back to the good old days of Teekay Tankers resuming, kind of capital return?

Stewart Andrade: Hi Jon. Yes, good question. So, if you look at the chart on page eight, you can see that in 2020, we were down to a net debt to cap in the low-30s and the fact that's the end of 2020, mid-2020, we were probably about 30%. So, I would say that our first work that we have ahead of us is to get our leverage levels down to that kind of level. As you said, there's a lot of different metrics that we could use but using net debt to cap is probably as good as any. So, I'd say the first step is to try and get down to our 2020 levels that's in the 30% zone, and then we can - then we'll start thinking about other uses of capital.

And part of that is looking at the long-term and our needs for fleet renewal, the ability to act opportunistically on opportunities as they come down the pike to be aggressive within charters if the market presents those opportunities. So, we don't have a magic number that we're trying to get to but we do think ultimately the financial strength is the best way for us to create value for shareholders. As we saw in the recent two years, even though our leverage was quite low in 2020, we had done a good job in reducing leverage in 2020 where we and the rest of the tanker market were already in a position where the concept of liquidity and leverage levels had come to be a concern again. So, we know in the tanker market there can be that cyclicality and we want to make sure that our strong financial position make sure that we're always in a position to take advantage of opportunities as opposed to taking steps that could damage shareholder value.

Jon Chappell: Okay. That makes sense. And then from the opportunistic standpoint, I mean, you're still selling older ships and you still have a few legacy in your fleet, asset value that's certainly inflected. So, I think no one would fault you for that. But how do you, kind of align modernizing the fleet through more modern assets again when the asset values are starting to run away? I mean, do you have to be more disciplined when you think about adding more modern tonnage at these prices, especially before you get to maybe a true inflection in the earnings of the cash flow?

Stewart Andrade: First of all, maybe let's talk a little bit about our fleet. We've got 50 vessels right now, 49 of them with spot rate exposure, as you've seen in our percentage fix in our Q2 results, our vessels are doing very well and generating a lot of cash flow. So, we really like our fleet. And from a perspective of the amount of capital that we have invested relative to the cash flow that they can generate, we think that we're almost ideally positioned in this period of what we expect to be a strong tanker market.

But of course, we do have to have our eye forward on fleet renewal as well. The word use there I think is important, and that's disciplined, and we do want to be disciplined about how we look at fleet renewal. Making significant number of acquisitions at the top of the market is a dangerous thing to do for any tanker market. Of course, on a portfolio basis, we could bring some ships in. The 50-tanker fleet, if we added a few vessels at different points in the cycle, that can still be the right thing to do but I wouldn't expect significant acquisitions at the top of the market from us. And I think in the meantime, we'll just be enjoying what we hope will be strong cash flows from the existing fleet and being patient.

Jon Chappell: Okay. That makes sense. And one more if I may for Christian. The slide six is great. It lays out pretty simply the trade flows. And I think we're not even kind of there yet because sanctions haven't truly kicked in yet, but as we look at these new trade routes that you've laid out here, obviously the mid-sized crude carriers have been direct beneficiaries and immediate beneficiaries of some of the new trading routes. At some point, does the VLCCs start to benefit as well either from the impact of sanctions, or from just cannibalization of some of the mid-sized routes?

Christian Waldegrave: Hi, Jon. Like you pointed out, I think the benefit that we've seen so far have really been on the mid-size because of where the regions impacted. Obviously, the VLCCs can't trade into the Baltic or into the Black Sea. So, where we've seen changing trade patterns and stuff going longer haul, it's really helped the mid-size.

As we've pointed out, the VLCCs have been lagging and I think that's more a factor of Chinese import demand did slowdown in Q2 with COVID lockdowns and I think with a strongly backwardated oil market that we've had in recent months as well, they've kind of disincentivizes the long-haul movements from the Atlantic into the Pacific. But I think both of those are slowly changing. I think Chinese demand is starting to come up again now. It's not necessarily being reflected in higher imports yet, but I think as China continues to recover from COVID and demand increases through the balance of this year and into next year, I certainly think we'll start to see more volume slowing into China, which is naturally a VLCC trade.

And then also if you look further ahead, there's not a ton of spare supply capacity in OPEC so where the oil supply is going to come online, increasing over the next 12 months to 18 months, is going to be from the Atlantic basin. There's going to be more US production and exports more from Brazil and Guyana. And so again, if we start to see some more of those long-haul barrels moving again, then that will kick start the VLCC market.

So, I'm not sure that the VLCCs will really be a big beneficiaries of the change in trade patterns as a result of Russia, but I do think as China comes back and we start to see those long-haul movements again, that will bring up the VLCC rates and then if we have a healthy VLCC market it’s going to help the rest of the tanker market as well.

Jon Chappell: That all makes sense. Thanks so much, Christian. Thanks, Stewart.

Stewart Andrade: Thanks, Jon.

Operator: Thank you. We take our next question from Omar Nokta with Jefferies. Your line is open. Please go ahead.

Omar Nokta: Thank you. Hi guys. Just wanted to follow-up on Jon's sort of line of question regarding the fleet and potential renewals and the leverage. Stewart, you mentioned net debt to cap being around 39% and trying to get it to where you were before, around that 30% level. It does feel like we're on that path here and you may be able to achieve that before year-end. But also maybe just judging maybe from your body language or from – via the audio, it does sound like maybe you aren't itching to pull the trigger on anything just yet. Is there something else beyond just the leverage ratio that you're looking at that's going to indicate whether you're ready to start the next wave of Teekay Tankers' lifecycle?

Stewart Andrade: Yes. Hi, Omar, and welcome back to the call and for working with Jefferies. So, good to talk to you. Yes, that's a good question and clearly, we look at more than just the leverage number and trying to decide how we're going to gauge capital allocation. We look at the tanker market, how long we think the cycle will last, our view on how much cash flow we'll be making in the forward years. We look at the opportunities that we think may be presenting themselves to us in terms of where asset values would be and when we might want to invest and we also look at our fleet profile and look at fleet renewal.

So, as you've seen over the last couple of years, we have been selling some of our older tankers, sort of 2003 to 2005 built tankers. We're not big sellers of tankers at the moment. Obviously, we sold one - we agreed to sell one during the quarter for almost $25 million, which is a very firm price and made a lot of sense, and we brought in a time charter to balance that off to keep our market exposure. So we're looking at all of those factors and trying to decide where we think our leverage should be.

And again, maybe just walking through it as you've asked the question. The first line is that we want to make sure or do our best to make sure we're not in a position where if the market does turn or whenever the market turns that we're not needing to take actions that harm shareholder value, whether that's raising capital with expensive rates or divesting of assets that we'd rather not divest at lower levels. And then the next line I suppose is to make sure that we have the capital on hand to be opportunistic and do deals when they present themselves, if we think that they'll add shareholder value. And then I guess the third one ultimately is to be able to countercyclically to make investments at the best time. And we look at all of those things in trying to judge how much leverage we think we should carry, and how much firepower we should have.

So, definitely one of our eyes is looking forward toward eventual fleet renewal and judging how much capital we need to think about having in order to do that as well. In the meantime, as highlighted on the slide with our free cash flow yield, every dollar of cash flow that we generate above that breakeven level goes to creating NAV, which creates shareholder value. So, we see that paying down debt is a way to create shareholder value. We think that creates value in the enterprise. And ultimately, hopefully as cash flows increase across the tanker market, the equity markets will also recognize that and hopefully start to reward companies in the space.

Omar Nokta: Thank you. That's very well said in detail. And I agree with you. Definitely paying down debt is - there's nothing wrong with that. And I guess just what you mentioned about the Aframax that you sold, I guess that's pretty much it you think at this point if we were to characterize Teekay Tankers going forward, it's not really a seller, it's kind of at this point harvesting the existing fleet?

Stewart Andrade: Yes, I would say that primarily harvesting the existing fleet is where we're focused, but to be honest, before we sold that tanker, I wouldn't have characterized this as sellers either. But depending on the positions of a vessel, it's particular characteristics and what a buyer is looking for. Opportunities can present themselves that are compelling. So, again, in this case, we did what we considered to be a really great trade, which is we sold a tanker that had about three years of trading life at extremely firm rate, and we brought in a two-year time charter to kind of replace those spot days. So, we find ourselves, sort of net-net not in a materially different position from our exposure to the spot market, but with being able to crystallize a very firm value. So, I would say that we're not sellers at the moment, but we're always looking for opportunities to add value through doing different sorts of trades.

Omar Nokta: Okay. Thank you. And maybe just one final follow-up. A lot of times when we talk about TNK investors ask about dividend potential. And if I'm just hearing you right, dividends obviously would be nice, and I think Jon mentioned the good old days. It would be great obviously to have a dividend policy, but it sounds like here, first and foremost, strengthen the balance sheet. So, you've got an eye enhancing and modernizing the fleet. That is - modernizing the fleet, once you get to that point where you're ready to now deploy capital differently, it's really about strengthening the fleet profile and then after you've done that, it's return capital to shareholders.

Stewart Andrade: Well, I don't want to predict what the future will hold. We could be in a run here, a multi-year run, which sees very firm rates, high cash flows and high asset values for a sustained period of time, or some of the things that we've discussed in terms of macro risk could come to bear, which could mean we have great cash flows for a year or two and then the market gets softer for something that we haven't seen or an unforeseen event. So, I don't want to get in a position. It's the tanker market, I don't want to get in a position of predicting the future.

What I would say is that for the time being, we want to reduce our debt levels. We're considering all the things I mentioned earlier in terms of capital allocation in our forward view of the market, and we'll continue to try and make the decisions that we think will ultimately add the most shareholder their value, but we're not, sort of dogmatic in our view of how it needs to be done. We need to be dynamic and kind of monitor the market and our forward view.

Omar Nokta: Got it. Understood. Thanks for the time.

Stewart Andrade: Great. Thanks, Omar.

Operator: Thank you. As a reminder, ladies and gentlemen, please press star, one to ask a question, star, one to ask a question. We'll take our next question from Ken Hoexter with Bank of America. Your line is open.

Ken Hoexter: Great. Good morning, Stewart and safe travel to Kevin. What gets you at this point to consider moving to charters from spot? Is that something Teekay will look at if rates start to get to certain levels? Are there levels you would talk about? And maybe talk about how negotiations are going with customers.

Stewart Andrade: There isn't a magic level. Whenever we're looking at time chartering vessels out and in for that matter, we look at the overall portfolio, how much spot rate exposure we have, and our forward view of the market, and we look for opportunities where perhaps we could lock in rates that are either higher than where we see the forward market being, or that are compelling in relation to where we see that forward market being where we're just happy to have a hedge in place that sort of guarantees of some cash flows. And it's the same on the other side within chartering vessels, looking for opportunities where we think we may be able to see windows of opportunities.

So, while the spot market has moved up, the actual charter that we entered into recently was an in-charter of $23,000 a day, which we think is compelling and adds value. As you saw the last time the market spiked, which was more of an event driven spike back in 2020, we were quite active in putting ships out that we thought that was a compelling opportunity.

So, we'll keep our eye on the time charter market. At the moment, I would say that the rates are continually stepping up for Aframax and Suezmaxes right now in the two-to-three-year period. There's not a lot of liquidity in that market. There's sort of a small trickle to vessels that are being put on the market and being chartered. So, not a lot of liquidity right now, but we will keep our eye on that and if those rates continue to move up, I would expect that at some point we would lock in a certain number of vessels. But again, that will be relative to our forward view. And as we outlined in the presentation, we feel really good about the market heading into 2023, 2024, 2025 based on the fundamentals.

Ken Hoexter: Is there point where Stewart, you and Kevin said, we still always want to be at least, I don't know, 50%, 30% exposed to the spot market because that's who we are now, given we've played the other game in the past? Is there a new philosophy on how much you need to keep spot exposed or if rates get to, I don't know, pick your number 50,000 a day, you'd say, no, I've got a - I'm good to lock that in for an extended period of time.

Stewart Andrade: First of all, just practically speaking with 50 vessels and 49 of them spot at the moment, there are limitations on the amount of vessels that you can put up on time charter. There's only a certain amount of liquidity in that market. So, even if we thought we were to point in the market where we'd want to be aggressive and put vessels out, I think it would be unlikely we'd be able to put out more than half a fleet just to choose a number. So, I think TNK will continue to have healthy spot rate exposure, and then we'll try to supplement and add value with how we position ourselves on in and out charters.

Ken Hoexter: That's great. Put a parameter there. What about the asset sale you mentioned on the 2005 vessel, was that specific to the vessel age? Was it something about the vessel? Was it just being opportunistic as you mentioned $25 million gain, maybe just thoughts on maybe some more thoughts on the sale?

Stewart Andrade: First and foremost, the asset market has moved up. So, when we talked to you three months ago versus now, asset values have moved up considerably across Aframax and Suezmax segments for sure. So, I would say the underlying thing there is just that we have a firming market. For that particular sale, I think it's just a matter of the characteristics of that vessel, the buyer, where the vessel was positioned, when we could deliver it, and it all sort of came together with quite a firm number.

But I think the big story there really is that the asset market has moved up and it’s really quite firm and people are paying up quite high prices for mid-aged and older tonnage. But I think that really speaks to people's confidence in the underlying spot market and how much cash flow they're going to be able to generate. What we've walked through on today's call, in terms of our outlook for the market, I don't think it's unique to us, I think a lot of people are seeing that and I think it's having the knock-on effect on asset values.

Ken Hoexter: Great. Last one for me, Stewart. On the - I guess given the backdrop on the global economy more on the container side versus everything on your side of the table, are there - in your discussions, are you seeing any yard fluctuations in terms of availability of openings where you could see more product or crude, kind of tankers there, or is it really firm and that is really the true number and you're not going to see, kind of slots opening for build capabilities?

Stewart Andrade: Christian, do you want to take that one in terms of the current orderbook?

Christian Waldegrave: Yes, sure. I think we're not seeing anything in terms of container ordered sailing or yard spots opening up. Certainly, if you look at the chart we put on slide seven, the shipyards are pretty full through - halfway through 2025, maybe even through to the end of 2025, and certainly some shipyards are taking LNG orders through 2026. You may be able to find a few berths still late in 2025, but I don't think it's going to be massive amounts. So, we're pretty confident still that the tanker delivery scheduled in 2025 is going to be very low as it will be in 2024 as well. So, we really don't see an opportunity to really order tankers in scale until 2026. So, that obviously gives us a bit of runway in terms of some confidence on the very low fleet growth expectations over the next two to three years.

Ken Hoexter: Great stuff. Great setup. Stewart, Christian, thank you very much for the time. I appreciate it.

Stewart Andrade: Thanks Ken.

Operator: Thank you. It appears there are no further questions at this time. I would like to turn the call back to your host for any additional or closing comments.

Stewart Andrade: Thank you for joining us today, and we look forward to speaking with you again next quarter.

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