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

Company: Teekay Tankers Ltd.

Date: Thursday, 12th May 2022

Conference Time: 11:00 ET

Operator: Welcome to Teekay Tankers Ltd.'s Third 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 a question. For assistance during the call, please press star zero on your touchtone 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.

Ed: 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 third 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 third 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, Ed. Hello, everyone, and thank you very much for joining us today for Teekay Tankers Third 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 three of the presentation, Teekay Tankers generated total adjusted EBITDA of approximately $92 million in the third quarter of 2022, an increase of over $33 million or 57% from the second quarter of this year. We reported an adjusted net income of nearly $58 million or $1.70 per share during the third quarter, an improvement from nearly $26 million or $0.76 per share in the prior quarter. Our improved results quarter over quarter were primarily due to higher spot tanker rates.

In a counter-seasonally strong market, we benefited from having 98% of our fleet in the spot market, which in turn enabled us to reduce our net debt to capitalization to 35% at the end of the quarter and to increase our liquidity to more than $250 million.

A strong charter market for mid-sized tankers is being driven by both tanker market fundamentals and geopolitical factors. Mid-sized tanker voyages have materially lengthened as a result of the conflict in Ukraine, driving up charter rates that are expected to stay strong throughout the winter months. At the same time, the continued absence of new tanker orders means that we expect to see minimal or even negative fleet supply growth through 2025.

Turning to slide four, we look at recent developments in the spot tanker market. Spot tanker rates continue to firm during the third quarter, counter to normal seasonal trends. Average mid-sized spot tanker rates were the highest for our third quarter since 2008, as shown by the chart on the left. The strengthened rates was primarily due to a combination of a continued rerouting of Russian oil exports from Europe to Asia, which has created significant tonne-mile demand in the mid-size segment, as well as Europe replacing Russian barrels with imports from more distant sources, including the US Gulf, Latin America, West Africa, and the Middle East. I will give more detail on Russian trade flows and their impact on mid-size tanker demand later in the presentation.

Turning to slide five, we provide a summary of our spot rates in the fourth quarter to-date. Fourth quarter to-date rates have improved as we moved into a seasonally stronger quarter. Based on approximately 43% and 38% of spot revenue days booked, Teekay Tankers' fourth quarter to-date, Suezmax and Aframax bookings have averaged approximately $40,000 per day and $36,600 per day, respectively. For our LR2 fleet, based on approximately 36% of spot revenue days booked, fourth quarter to-date bookings have averaged approximately $44,700 per day. Overall, these rates are approximately three times higher than last year's fourth quarter spot rates.

Turning to slide six, we provide our expectations for the upcoming winter market. As outlined previously, the reshaping of oil trade flows following Russia's invasion of Ukraine has increased mid-sized spot tanker rates year to date. However, the rerouting of Russian crude oil away from Europe is only partially complete.

As shown by the chart on the top left, European seaborne imports of Russian crude oil have fallen just over 2.5 million barrels a day at the start of the year to around 1.5 million barrels per day by September. However, from December 5th, these volumes are set to fall to zero as the EU ban on Russian crude oil imports by sea comes into effect. Thus far, these volumes have been replaced almost barrels per barrel by imports from the US Gulf, Latin America, West Africa, and the Middle East, as shown by the chart on the top right. As Europe continues to reduce its imports of short-haul Russian crude, they'll need to source additional replacement barrels, which will come from much further away in terms of sailing time. As an example, a voyage from the Russian Port of Primark in the Baltic Sea to Rotterdam in Northwest Europe is approximately four days in duration. In comparison, a voyage from Houston to Rotterdam is approximately 17 days in duration. Europe's replacement of Russian barrels from other sources is therefore creating significantly longer voyages, thus more tonne-mile demand, and it is set to increase further once the full EU ban comes into effect.

At the same time, Russia is having to find new customers for the oil that is no longer being sold into Europe. As shown by the chart on the bottom left, most of this oil has been flowing to Asia, in particular to India. Again, this is significantly increasing tonne-mile demand due to the distances involved. With the distance

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from Primorsk to the West Coast of India being almost 7,500 nautical miles or 26 days. Looking ahead, we expect that Russia will look to divert more barrels into Asia once the EU ban comes into full effect. China could look increasingly to Russian imports as their import requirements grow with the Chinese government recently issued 15 million tonnes of new export quotas to their refineries for Q4 2022, as well as the first batch of crude import quotas for 2023.

The net impact of these trade flows is displayed on the chart on the bottom right. It shows the change in tonne-miles in January 2022 compared to September 2022 on these three trade routes. As shown, the loss in tonne-miles from Russian exports to Europe has been dwarfed by the combined positive tonne-mile impact of the increased Russian exports to Asia and by Europe's replacement of Russian barrels from more distant sources. This trend is set to continue in the coming months, which we believe will further drive mid-sized tanker tonne-mile demand.

While the redrawing of global trade patterns is the largest single factor behind the current strength in rates, there are other reasons to be optimistic about tanker rates in the coming months. Global oil demand is being boosted this winter by increased gas-to-oil switching, particularly in Europe due to the high cost of natural gas. In addition, we expect normal seasonal factors such as weather delays to add to further volatility. Partially offsetting these positive factors is the recent announcement from OPEC+ of a 2 million barrel per day supply cut starting from November. Many OPEC+ countries, however, are already struggling to meet production targets, which means the actual cuts will likely be closer to 1 million barrels per day, most of which will come from the Middle East. This is expected to primarily impact the VOCC sector rather than mid-sized tankers and therefore, we did not see this as a significant negative factor for Aframax and Suezmax spot rates through the winter months.

Turning to slide seven, we look at positive tanker supply and demand fundamentals over the next two to three years, which we believe point towards the potential for sustained tanker market strength.

Fleet supply fundamentals out 2025 continue to look very positive as a lack of new tanker ordering is leading to a rapidly shrinking orderbook. As shown by the chart on the left, 2022 is on track for the lowest level of new tanker orders in 35 years, with a projection of around 6 million deadweight tonnes at the current pace of ordering. This is highly unusual given the relatively strong spot tanker market in recent months as periods of stronger freight rates have in the past tended to result in an increase in new tanker orders. However, very high newbuilding prices, a lack of shipyard capacity through the end of 2025 due to high levels of container ship and LNG carrier orders, and uncertainty over vessel technology have deterred owners from ordering new tankers during the current upturn. As a result, the orderbook when measured as a percentage of the existing fleet has fallen to a record low of just over 4% as of October of this year. Coupled with an aging tanker fleet, we expect low fleet growth in 2023 and potentially negative fleet growth in 2024 and 2025.

Turning to the outlook for tanker demand, a potential slowing of the global economy due to inflationary pressures and rising interest rates means that the outlook for 2023 has become more uncertain. However, major oil agencies are still forecasting a relatively robust oil demand growth next year due to continued gas-to-oil switching and an expected post-COVID rebound in Asian oil demand, particularly in China. Global oil demand is expected to grow by 1.8 million barrels per day in 2023 as per the average of forecasts from the IEA, EIA, and OPEC, which would return demand to pre-COVID levels. More importantly, the continued redistribution of Russian oil exports, as outlined earlier in the presentation, would drive average voyage distances higher and spur increased tonne-mile demand. As per Clarkson's, tanker tonne-mile demand is expected to grow by over 6% in 2023 and around 5.5% in 2024, far outstripping fleet supply growth of just under 1% and -1% respectively, which should help tanker freight rates remain firm albeit volatile over the next year and beyond.

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

Stewart Andrade: Thanks, Kevin. Turning to slide eight, we highlight the company's capacity for creating significant shareholder value. Given our 49-vessel fleet and with almost all vessels trading in the spot market, Teekay Tankers continues to generate significant cash flow benefiting our shareholders by building further financial

strength and rapidly increasing equity value through the repayment of debt. As can be seen in the chart, our fleet-wide free cash flow breakeven level, including dry-docking and other capital expenditures is approximately $15,000 per day. For every $5,000 per day increase in spot rates above this level, the company is expected to generate approximately $85 million or $2.50 per share in annual free cash flow.

As we approach the seasonally stronger winter period, Teekay Tankers is poised to continue strengthening its financial position and creating shareholder value. As an illustration, at the current fourth quarter-to-date rates we would expect to generate free cash flow of approximately $12.50 per share in the next year, which equates to a free cash flow yield of approximately 38%.

I will now turn the call back to Kevin to conclude.

Kevin Mackay: Thanks, Stewart. In summary, with a very limited number of newbuilds set to join the global fleet between now and 2025, we see significant structural support for the current strong spot market despite potential macroeconomic headwinds to oil demand. On top of that, the tonne-mile impact of Europe turning away from Russian oil has proven to be sizeable and appears to be long-lasting, and the forthcoming EU ban from early December is set to significantly increase that impact.

Mid-sized tankers like those in the TNK fleet continue to be disproportionate beneficiaries of these supply chain shifts. By positioning our fleet to trade spot, we are very heavily exposed to the current tanker market strength and our high operating leverage means a strong tanker market translates directly into TNK's free cash flow. We continue to focus on reducing our leverage in a manner that we think is prudent and that positions us well to be successful over the long term.

With that, operator, we're now available to take questions.

Operator: Thank you. If you do wish to ask a question at this time again, please press star one on your telephone keypad. Please ensure the mute function on your telephone is switched off to allow your signal to reach our

equipment. Again, it is star one to ask a question. And we can now take our first question from Omar Nokta of Jefferies. Please go ahead.

Omar Nokta: Hey, guys. Thank you. Good morning. Kevin, you went through the tonne-mile impact we've been seeing this year due to the evolving trade patterns as a result of the war. Your fleet obviously being focused exclusively on the Suezmax and Aframax. It's been in the sweet spot of being the most in demand as a result of all this.

I just wanted to ask, with the ban now coming into effect here, starting in about a month's time, what have you seen so far as a response ahead of that? Are you seeing anything that's transpired differently here over the past few weeks? What are charters doing from your vantage point, perhaps differently to prepare?

Kevin Mackay: Thanks. Hi, Omar. Generally, we haven't seen a material impact up till now. I think given the duration of voyages going into Europe, we probably won't see that for maybe another week, potentially another ten days. We are seeing heavier volume coming out of the US Gulf and I think that's why you've seen US Gulf routes on Aframax has jumped to over $90,000 a day because the disconnect between the number of ships available to move those cargoes.

We're also seeing a growth in lightering exports in the US Gulf shipping onto VLCCs, some of which will be going to Rotterdam. So I think that's the early sign of this ramp-up in imports destined for Europe. But beyond that, we haven't yet, I don't think, seen a broad reaction across all different trade routes yet.

Omar Nokta: Okay. So presumably, I guess the next few weeks we'll start to see the impact of that. Thanks for that, Kevin.

Kevin Mackay: It's also important to note that the US has also just recently come out and given a bit of a stay of execution, if you will, acknowledging that there will be shipments that are done prior to the ban coming into effect that might not be able to complete before the December 5th ban and they've extended he allowance

for those legal voyages to execute and deliver their barrels up until I think it's the 19th of January. So maybe that's potentially why we haven't seen the ramp-up as early as maybe you're expecting.

Omar Nokta: Okay. Thanks for that. Very helpful. And then just maybe just to shift gears here a bit. Obviously, you guys over the past several years have been really focused on strengthening the balance sheet, building liquidity, and you've lowered the net debt to cap here into the low 30s. How do you think about – you get this question a lot then I guess I have to ask it, but how do you think about your use of cash here for the rest of, say, this year? And does that shift at all as you get into 2023 or deeper into 2023? Any color you can give?

Kevin Mackay: Yeah. Fundamentally, I think we've said this several times over the last few years. As management, we believe that we'll create more long-term value for shareholders by running the company from a position of real financial strength. We've just recently experienced a fairly brutal, almost two-year downturn in tanker market and we've only just started to come out of that in the last quarter or two, which has been great. We've gained ground over the last couple of quarters on the inroads that we were making to reduce our financial leverage and we're happy with the progress we're making so far. But our intention at this stage is to continue to really focus on paying down debt as we've said on previous calls.

Omar Nokta: Okay. All right. That's clear. Thanks, Kevin.

Kevin MacKay: Thanks, Omar.

Operator: And we can now take our next question from Jon Chappell of Evercore. Please go ahead.

Jon Chappell: Thank you. Good morning or good afternoon. Kevin, I'm going to ask that question a different way, just based on some of the numbers. If I look at this slide that Stewart put out there with the $12.50 of annualized free cash flow per share based on the fourth quarter to date numbers and layer that in with the slides that you presented that shows tonne-mile demand easily dwarfing fleet growth over the next couple of years. That $12.50 a share based on your share count would basically pay off your entire debt profile

immediately. So maybe another way to ask it is what do you need to see before you shift gears back to what TNK was when it was formed 15 years ago with a more direct capital return based on the earnings profile of the company.

Kevin MacKay: Well, first off the bat Jon, you're coming having been through the last 15 years as a company you obviously learn things and one of the things we've learned as a management team is that in a tanker industry that is highly cyclical, it's prudent to arrive at the market from a position of strength. So the way we look at this, we want to further strengthen our balance sheet to really meet three goals. And I think Stewart articulated this on the last earnings call. Primarily, we want to avoid any type of financial distress for the company as we move through a variety of tanker cycles and as you said, the way we're generating cash, if this market sustains at these levels that box will be ticked fairly shortly here.

But beyond that, we also want to have the capacity and the financial strength to act opportunistically when we see good deals that add value coming along and that could be the ability to take on more in-charter exposure, it could be looking at different technology additions, it could be a variety of things, including ship purchases; just to be able to act more opportunistically and with a trader approach to use our financial strength.

And then finally, it's more the structural strategic leg that we're trying to fill, and that is to have this financial strength to make material investments in our fleet as we move through the cycles. So yes, it's about paying down debt. But it's also about positioning the company financially to give us the ability to look at a variety of opportunities in the future that drive long-term shareholder value.

Jon Chappell: Okay. So let's follow up with that then with my follow-up on renewing the fleet. By my count, roughly 75% of your fleet will be at least 13 years of age as the calendar flips to 2023, asset values are ripping right now. How do you balance investing for the long term, given asset values that have kind of become parabolic versus modernizing a fleet that as you've delivered, has aged a bit, probably more than you would have liked?

Kevin MacKay: Well, I think, first of all, let me make it clear. I think we're very happy with where our fleet stands today. We're happy with the size of the fleet. We're happy with the exposure that we have. We're happy with the market that we are anticipating going ahead. So we're in a position where we're comfortable. Over the long term, though, fleet renewal is definitely something that we will need to do and act on. But the acquisition timing and finding the right deals is really crucial to being a successful tanker company.

So I think you've seen us already start the process. We've divested several ships in that sort of 2003 to 2000 built era over the last 18 months, as asset values have climbed. So selling off these older tonnages into this strong asset environment has begun. We're bringing in a modern newbuild in January next year on a long-term time charter basis at very attractive rates. So that's adding to some of the renewal.

In terms of newbuilding and secondhand values at the moment, both, we don't see attractive pricing at the moment. We don't think that doing something now would add long-term value. As I said, we're comfortable. We don't feel that even with an average age of 13, that it's something that we need to run out and do acquisitions for the sake of it, no matter what the terms are.

So I think it's more around building that financial strength, building the balance sheet up so that when the opportunities do arise and we do see value returning to some of these markets, that we have the balance sheet to be able to act on it. So I think it will require a bit of patience and taking our moments.

Jon Chappell: Okay. Thanks for the thoughts, as always, Kevin.

Kevin MacKay: Thanks, Jon.

Operator: And we can now take our next question from Ken Hoexter of Bank of America. Please go ahead.

Ken Hoexter: Hey, great. Good morning, Kevin, Stewart, and Christian. Maybe talk a bit about the rates now in the 40s. You mentioned chartering in some vessels coming up. Is there a chance you move to charter out and lock in these rates, or do you still want to as you mentioned, it's only been a few quarters that you've entered this upswing? Do you kind of wait this out a little bit longer, maybe talk about a bit more about your philosophy there?

Kevin MacKay: Hi Ken. I really don't think our philosophy changes in terms of out-chartering or indeed in-chartering. The numbers are obviously very different, but I think our approach to the idea of the charter portfolio doesn't change. So at the moment, as I said, we're extremely happy with the fact that 98% of our fleet is exposed to this market. We're not in a hurry. We think the winter market definitely has some more legs here. But we are looking at opportunities that are out there and evaluating them against what our forward view is. We haven't executed on anything as yet. But that doesn't imply that we're not turning over stones and having a look at what's out there. And I think looking at our fleet size of nearly 50 ships exposed to this market, we have the capacity to put away a few ships and I think you'll probably see us do that at some point over the winter and into 2023 for various durations because it makes sense if you can lock in some attractive numbers at high levels it saves you having to do that work in the stock market.

So I think it's something that we've always looked at, it's something we continue to look at and I think that doesn't just mean out-chartering as well. I think you will probably also see us look at potentially bringing more ships in. If there's an ability for us to make a margin, you will see us do that as well.

Ken Hoexter: Yeah. So I guess as we went through this, you wanted to make sure you were exposed to the spot. Now you're saying as we go through the winter at these levels, maybe there is room, is there a percentage you'd want to maybe limit that to, is it 10%, 25% of the fleet that you'd want to be to keep that spot exposure? Or is there no set thought there?

Kevin MacKay: No, it's not. We don't look at it formulaically, a lot of it adjusts week over week, month over month as we see things developing in the market, be it geopolitical issues or fundamental issues around tanker

rates. So we don't go into the year or into the winter with a fixed percentage in mind. And we really just evaluate individual deals on a case-by-case basis.

Ken Hoexter: Thanks, Kevin. So let me ask a follow-up on the different subject back to the Russia. Maybe just talk about, you talked about what's left here. Is there a point where you would start to get nervous of the unwind if there's peace or how long that would take? I guess I'm trying to understand how stable you think this new world order and environment can be at least? Is it at least the next year or two years? How long do you think the permanency of this setup as you get this longer tonne-miles kind of built into the network?

Kevin MacKay: You're essentially asking me to read Putin's mind. In any environment like this, obviously, a war between two significant countries is obviously not something we deal with all the time. It's something that we have to, like all participants in any industry, we have to read and try and understand where this might be going, but we can't project that far. It's just too far out.

What we can look at is the fundamentals that are underpinning our market and those are very strong as I've articulated in the presentation. And for now, the tonne-mile increase we think has been durable now for, what eight months? We think it will be durable definitely through the winter and possibly through the end of 2023. But you never know, we can't guarantee that. So you always have to keep an eye on developments and see and react accordingly.

Ken Hoexter: All right. Fair answer to a tough question. Maybe just one more, if I can. Just the orderbook. Given where rates are, I get the structure. I understand how thin the orderbook is. Is there anything the yards are doing to create spots? Are they looking at these rates and where they are and trying to open up spots, or are you seeing any loosening of that, or your peers going to place some new orders in at this point? Maybe you could talk about if there's anything that could disrupt that part of the equation.

Christian Waldegrave: Yeah, Hi Ken. No, in terms of shipyard capacity opening up, we're not really seeing anything there. If you look at the orderbook, I think for 2024 it's pretty much set. There's no spare capacity at the yards.

For 2025, there is still some capacity for second half of the year. Not so much of the big three Korean yards, but it's some of the smaller, or more medium-sized Korean yards and in China. But it's not enough capacity that could swamp the 2025 orderbook and cause a material increase in tanker fleet growth.

And on the owners side, it's quite remarkable that given the charter rates we're seeing, we haven't had much tanker ordering at all. If you look at this year, we've only had about 5 million deadweight of tanker orders. Now you go back to 2015, which was a comparable year for tanker rates, we had 30 million deadweight of orders. So I think the kind of triple problem of high newbuilding prices, not a lot of shipyard capacity, and questions still over vessel technology is deterring orders. So for now, we don't see much red flags with regards to that 2025 orderbook. We still think that it's going to be a very low year for tanker deliveries and possibly negative fleet growth again in 2025.

Ken Hoexter: Great. Thanks, Kevin, Christian and Stewart, appreciate the time.

Kevin MacKay: Thanks, Ken.

Operator: And with no further questions at this time, I would now like to hand the call back to the company for closing remarks.

Kevin MacKay: Thank you for joining us today and we look forward to speaking to you in three months' time. Goodbye.

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