TEEKAY TANKERS LTD.'S FIRST QUARTER 2023 EARNINGS RESULTS CONFERENCE CALL

Company: Teekay Tankers Ltd.

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Conference Time: 11:00 (UTC-05:00)

Operator: Welcome to Teekay Tankers Ltd.'s first quarter 2023 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 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 first quarter 2023 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 of 2023 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 Tanker's first quarter 2023 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 $206 million in the first quarter, an increase of approximately $26 million from the fourth quarter of 2022. We reported our highest ever quarterly adjusted net income of nearly $175 million or $5.13 per share, an increase from a record fourth quarter of 2022 adjusted net income of approximately $148 million or $4.33 per share. Our strong results have enabled us to reduce our net debt by almost 50% since last quarter to $182 million. We've also finalized a revolving credit facility for up to $350 million to refinance 19 vessels as we continue to exercise purchase options on vessels in sale leaseback arrangements.

A strong fourth quarter spot rates and our high operational leverage, Teekay Tankers generated almost $194 million of free cash flow, including approximately $19 million from our eight chartering vessels. As previously mentioned, for every $5,000 above our free cash flow breakeven of approximately $15,000 per day, we expect to generate $2.64 in free cash per share annually.

Given the substantial progress the company has made in building financial strength and how well we are positioned to benefit from the strong tanker market. Teekay Tankers has transitioned to a capital allocation approach under which our existing focus on financial strength and disciplined future fleet reinvestment is supplemented by returning capital to shareholders. Namely, from this quarter, we have initiated a fixed quarterly dividend of $0.25 per share. In addition, based upon a holistic assessment of the company's position, including the last few quarters performance and our expectations moving forward, the board has also approved a special dividend of $1 per share. Finally, we've put in place a $100 million share repurchase program, which provides us with an additional lever to create shareholder value.

For mid-size tankers spot rates during the first quarter of 2023 were the highest ever for the first quarter of the year and remain firm, albeit volatile, in the early part of the second quarter. We've recently seen record high U.S. crude oil exports and crude volumes out of Russia remain strong, adding significant support to mid-size tankers. Overall global oil demand remains on track to increase by 2 million barrels per day this year, driven in large part by China's economic recovery and increased travel following the relaxation of COVID lockdowns. Perhaps most importantly, fleet supply fundamentals remain in excellent shape, with low fleet growth virtually ensured for at least the next few years.

Turning to slide four, we look at recent developments from the spot tanker market. Spot tanker rates remained at historic highs in the first few months of 2023. As mentioned, spot rates in Q1 were the highest ever recorded for the first quarter of a year, driven by record high crude oil exports from the U.S. Gulf and increase in long haul movements in the Atlantic to the Pacific, spurred by rising Chinese crude oil imports and an increase in Russian crude oil exports, which are now moving almost exclusively on long haul voyages to Asia.

Mid-size tanker spot rates have remained firm at the start of the second quarter, albeit with high levels of volatility, which is typical in a tight tanker market environment. We anticipate stock rates to remain volatile due to continued strong fleet utilization interspersed by typical seasonal factors in the coming months.

Turning to slide five, we provide a summary of our spot rates in the second quarter to-date. Average second quarter to-date rates have remained historically strong. Based on approximately 44% and 41% of revenue days booked. Teekay Tankers second quarter to-date for Suezmax and Aframax size vessel bookings have averaged approximately $62,400 per day and $58,500 per day, respectively. Importantly, I would highlight that TNK has eight ships currently chartered-in at an average cost of $24,300 per day, with a mark-to-market value of approximately $68 million. Six of these vessels are currently trading on the spot market.

Turning to slide six, we look at some of the factors that have been supporting mid-size tanker demand over the past few months. Firstly, U.S. crude oil exports have been on a rising trend in recent months and in Q1 reached a record high average of 4 million barrels per day, with some weeks reaching over 5 million barrels per day. Almost half of these volumes were shipped to Europe directly on Aframax and Suezmax tankers, leading to an increase in mid-sized tanker tonne-mile demand, with additional volumes being transported long haul to Asia on VLCCs, creating elevated demand for Aframax lightering in the U.S. Gulf.

Secondly, Russian seaborne crude oil exports has increased since the start of the year, with exports in Q1 reaching 3.4 million barrels per day, an increase of half a million barrels per day from Q4. Furthermore, over 90% of these volumes are now flowing long haul to India and China following the implementation of the EU ban on Russian crude oil imports, creating significant tonne-mile demand for mid-sized tankers given that VLCCs cannot load directly from shallow draft Russian ports. While Teekay Tankers does not transport Russian oil, the stretching of the mid-sized tanker fleet as a result of new trading patterns to import replacement oil to Europe coupled with a growing shadow fleet of ships to service Russian trades and which typically or generally trade less efficiently than the regular fleet, have benefited the wider mid-size tanker market. Although Russia announced an oil supply cut of half a million barrels per day from March of 2023 onwards, this is currently not being reflected in Russian crude oil export volumes, which remained firm in the early part of Q2.

Turning to slide seven, we look at the outlook for oil demand and supply through the remainder of this year. As per the IEA, global oil demand is projected to grow by 2 million barrels per day in 2023 to a record high of just under 102 million barrels per day.

Non-OECD countries led by China are expected to account for 90% of this growth, with OECD demand being impacted by slower economic growth due to high inflation and rising interest rates. Oil demand is expected to accelerate during the second half of the year, with Chinese economic growth gathered pace with reported GDP growth of 4.5% in the first quarter, providing a positive sign of an accelerating Chinese economy.

Looking at oil supply. The OPEC+ group announced that a surprise oil production cut of 1.16 million barrels per day from May through the end of the year in response to lower oil prices and uncertainty over the global economy. This may negatively impact seaborne oil volumes. And although the impact will primarily be felt in the VLCC sector, given that the majority of the cuts are from Middle Eastern producers, there could also be a negative knock-on effect for all crude tanker segments in the coming months.

Turning to slide eight, we look at the positive tanker supply and demand fundamentals, which we believe lay a strong foundation for extended market strength over the next few years. Fleet supply fundamentals remain very positive. The global tanker orderbook, when measured as a percentage of the fleet, remains at a record low of approximately 4%. Although the pace of new tanker ordering has picked up since the start of the year, most shipyards are now effectively full through the end of 2025. Furthermore, the number of new orders that have been placed is relatively small when compared to the fleet of older vessels, which will need replacing in the coming years and therefore, at this stage we do not feel this recent ordering uptake is having a material impact on overall fleet supply in the medium term. The combination of a small orderbook and little spare shipyard capacity through mid-2026 virtually ensures low fleet growth over the next two to three years, with approximately 2% fleet growth expected this year and negligible levels of fleet growth in both 2024 and 2025. As shown by the chart on the right of the slide, tanker demand growth is expected to far outweigh fleet supply growth over this time period, setting the stage for increased fleet utilization, which should drive an extended upturn in tanker spot rates over the medium term. I'll now turn the call over to Stewart to cover the financial slides.

Stewart Andrade: Thanks, Kevin. Turning to slide nine, we highlight the company's high operating leverage and what that means for TNK's capacity to generate cash flow and create shareholder value in a strong tanker market. With 96% of our fleet trading in a firm spot market, our earnings in recent quarters demonstrates the power of having 51 vessels trading in the spot market, generating significant free cash flow. As an illustration of that, if Q1-2023 spot rates continue for the full year, we would generate approximately $24 per share of annual free cash flow, equating to a free cash flow yield of over 60%.

Our strong cash flows have been used to strengthen TNK for the long term by rapidly paying down debt. In addition, they've allowed us to optimize our capital structure by exercising purchase options on vessels we had previously put into sale leaseback financing agreements. By Q4, we expect this optimization to have reduced our breakeven rate by approximately $400 per day.

Turning to slide 10, we look at Teekay Tankers updated capital allocation plan. As we have previously communicated throughout 2022, our capital allocation was focused on building balance sheet strength, and I am pleased that we have made excellent progress in that regard. Since the beginning of 2022, we have generated over $480 million of free cash flow, reduced our net debt by over $400 million to $182 million, and reduced our net debt to balance sheet capitalization from about 40% to less than 13%.

Highly supportive market conditions and our operating leverage enabled us to accelerate our progress and we are now pleased to revise our capital allocation plan. Our updated capital allocation plan will maintain a focus on building financial strength for future fleet reinvestments when market conditions are supportive. In addition, we are initiating a $0.25 per share fixed dividend. This dividend enables us to continue building financial strength while also consistently providing a return of capital to our shareholders. A holistic assessment that considered the Company's performance in recent quarters and our outstanding progress in building financial strength combined with our tanker market outlook and the company's future capital needs resulted in the board declaring a special dividend of $1.00 per share. While it is not our intention to utilize special dividends as a regular recurring supplement to our fixed quarterly dividend, we have chosen to do so at this time, providing not just immediate value to our shareholders, but also establishing a further means by which can optimize its capital allocation. Finally, we have put in place a $100 million share repurchase program, which provides us with another capital allocation tool, enabling us to act opportunistically to take advantage of equity market dislocations when TNK has excess capital. I will now turn the call back to Kevin to conclude.

Kevin Mackay: Thanks, Stewart. In summary, Teekay Tankers is in a great position with our sizeable fleet of well-maintained quality Aframax, LR2, and Suezmax tankers to benefit from the strong tailwinds supporting the mid-size tanker market. Robust tanker market fundamentals indicate multi-year support for healthy tanker market environment, which should enable us to continue creating shareholder value by generating meaningful cash flows, returning capital to shareholders and seeking opportunities to reinvest in our business and fleet in a disciplined manner. With that operator, we are now available to take questions.

Operator: Of course. Thank you. If you would like to ask a question, please signal by pressing star one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, it is star one if you would like to ask a question, we'll pause just for a moment to allow everyone an opportunity to signal for questions. And with that, we'll go ahead and take our first question from Jon Chappell with Evercore ISI. Please go ahead.

Jon Chappell: Thank you. Good morning, everyone. Before I start, I'd make a point not to pander on these calls, but I have to say, after several quarters of questions around your capital allocation, it's great to see a result there and it looks really great. So, congrats on that. Stewart, if I could start with you, a lot of the work that you've done on the balance sheet has put you in this position now to change the capital allocation strategy. 19 vessels that you've taken back from sale and leaseback, that'll be done, I guess, by the third quarter of 23. Can you just remind us how many would remain then starting in the fourth quarter under the sale and leaseback arrangements? And again, any timing on the ability to exercise options to end that structure as well?

Stewart Andrade: Hi, Jon. Thank you very much. We'll have eight vessels left in sale leaseback structures as of the end of the year and those come up with purchase options available toward the end of Q1-2024. So, we'll be in a position if we think appropriate to buy those ones back early next year.

Jon Chappell: Okay. All eight.

Stewart Andrade: There will be eight remaining in total under sale leasebacks at the end of this year.

Jon Chappell: Okay and all eight of those will be done by one. You have the option to do all eight of those by the end of 1Q 24. So, within 12 months.

Stewart Andrade: Correct. Yeah. In March 2024, we have purchase options on all eight of them.

Jon Chappell: That's right. Fantastic. Okay, great. Thank you. Kevin, for you. You mentioned the volatility and obviously there has been a lot of volatility and headline volatility, so to speak, as well. But it seems that every time we kind of get a little mark to market update, it's like the VLCCs and the MRs kind of the barbell have been more extreme, whereas the Suezmaxes and the Aframaxes, although they have been volatile by definition at a much higher range and a much tighter range, what do you ascribe that to and is it strictly that the most direct beneficiaries of a lot of the kind of redrawing of the trade map have been those two mid-sized crude asset classes? And do you think that that kind of sets a stage for a higher high and higher lows scenario within those two specific segments going forward?

Kevin Mackay: Hi Jon and thank you for your comments earlier. It's interesting when you talk about volatility and you've compared the barbells of VLCCs and MRs. If you just if you look at Aframax, if you want volatility, we were bouncing along only 10 days ago at around about OpEx levels and now we're over $120,000 a day in the U.S. Gulf; that's volatility. So, I think we're seeing it across all segments, not just at the bookends, but I think on average, we are seeing the aggregated monthly numbers or the quarterly numbers for the mid-sized tankers, specifically Aframax and Suezmaxes just held up stronger and that speaks to the direct impact that these new trade routes as a result of the Ukrainian war has really been focused on that more flexible vessel that the Aframax and Suezmax presents. I said in my remarks, we don't take part in the Russia trade directly but it's causing a dislocation while others refuse to go there, it's drawing them away from traditional markets and our concentration in the U.S. Gulf, in our lightering business and in the Atlantic as well as the far East, have helped us to keep the Aframax, and our presence in the Aframax market when it does spike, to give us the kind of returns that we're demonstrating on this call today. Yeah, I think the long story it really is, the last 12 months have really been a story about the mid-size tankers, not so much all sectors all at the same time. They've had periods of strength. But I think, as I mentioned in my remarks, the OPEC cuts are going to primarily affect the VLCCs. I think the Aframax and the Suezmaxes, whilst on a sentiment basis may be impacted, on a tonne-mile basis, may continue to be strong for the rest of the summer and into certainly into Q4.

Jon Chappell: Yeah, that makes a ton of sense. Thanks again, Kevin. Thanks, Stewart.

Stewart Andrade: Thanks, Jon.

Kevin Mackay: Thanks, Jon.

Operator: And we'll go ahead and move on to our next question from Omar Nokta with Jefferies. Please go ahead.

Omar Nokta: Thank you. Hi, Kevin. Hi, Stewart. Maybe just a touch of pandering from my angle as well. I would say congrats because you guys set off on this strategic approach maybe at least five or six years ago looking to balance or strengthen the balance sheet and you really ignored a lot of risks of taking advantage of uplifts that we saw in 2019, 2020 and you just stuck the course and here you are now, you've got Teekay Tankers to this position of being almost in a net cash situation. So, kudos to you guys. Did want to ask about clearly, you have the buyback, you've got the special that you just declared and you've got the ongoing $0.25 dividend. Based off of the way the market is you're generating a lot of free cash flow. How are you thinking about how that free cash gets utilized? Obviously, you just announced this capital allocation, so I'm not expecting you to just start talking about what to do with the excess cash. But just in general, how do you think about that free cash as it gets generated? Is that just go straight to the balance sheet, your effectively your debts almost gone. So, does the cash just build or do you now start to look at acquisitions and fleet renewal?

Stewart Andrade: Thanks for the comments, Omar. We are very happy with the progress we've made over the last few years and we think we're in a good position. In terms of the excess cash flow that we'll generate, I do expect if the tanker market stays strong that we'll quickly find ourselves in a net cash position and as we mentioned in our prepared remarks, it's really with an eye to making disciplined reinvestments in our fleet as we go forward. We can step back a little bit now and look at a bit more of a longer-term view of what's gone on with the company over the last several years. We've tried to be very disciplined and focused on building our balance sheet strength and we haven't invested in a tanker since the end of 2017. And so, we do need to reinvest but we're going to be very disciplined as we do that. But going forward, we want to continue to operate from a position of balance sheet strength, which means it will require a fair amount of equity in order to make those reinvestments. So, we'll be patient, we'll look for opportunities and when those opportunities arise, we think we'll be positioned to take advantage of them.

Omar Nokta: Thank you. That's good. And I guess just in terms of those opportunities, don't want to press too much because you do have the flexibility to not take your time. But in terms of, say, fleet additions, you can do the charter-ins as you've done here recently. You can buy ships out in the open market or you can order new ones. Euronav earlier this morning had mentioned looking at newbuildings within the Suezmax segment. How are you guys looking at newbuildings in general? Is that something that is compelling at this point? Or if you were to put capital to work, is it more towards secondhand or do you continue with the in- charter approach?

Kevin Mackay: Hey, Omar. And thanks, as well for the comments. I think we've said this before, when it comes to our fleet renewal task, it's we're really agnostic. Historically TNK has bought secondhand ships, it's ordered new ships, and it's done M&A. And I don't think that changes going forward. The challenge at the moment is, in our view, newbuilding prices relative to historic terms are expensive as are secondhand value. So obviously different owners have different views but from where we sit, we don't have plans on our books right now to go into the newbuild market at these kind of price levels.

Omar Nokta: Thanks, Kevin. Thank you. And maybe just one final follow up just on the new credit facility, the $350 million that will refinance the 19 leaseback vessels, you're going to be winding those down, obviously, over the next couple of quarters. How much of that $350 million are you expecting to draw initially once you've paid off the leases on the 19 ships?

Stewart Andrade: Well, it will depend how cash flow goes into Q3 and Q4. But we are able to reacquire the vessels from the sale leaseback arrangements initially with just a small draw on our existing revolver and not drawing anything on the $350 million. So, it'll be either a very small draw on the existing $90 million revolver or nothing. So, if we continue to see strong cash flows into Q3 and Q4, I would expect that we wouldn't need to draw anything.

Omar Nokta: Makes sense. Cool. Well, thanks, Stewart. Thanks, Kevin. I'll turn it over. Congrats again.

Stewart Andrade: Thank you.

Kevin Mackay: Thanks Omar. Appreciate it.

Operator: And our next question is going to come from Ken Hoexter with Bank of America. Please go ahead.

Ken Hoexter: Hey, great. Good morning. And again, I'll echo congrats on the reshaping of the balance sheet. Great job sticking with it. Kevin or Stewart, you're 96% spot exposed. I don't know, maybe your view of how long this lasts for in terms of rates. Obviously, you're confident by sticking with the spot. Do you look for some time charter opportunities to lock in these rates? Maybe your thoughts on the longevity of this kind of market.

Kevin Mackay: Hi, Ken. As we said in our prepared remarks, the way the fundamentals are set up and we said on previous calls the change in the trade patterns as a result of the Ukrainian war, we feel, in our opinion, are durable. So yeah, we do have confidence that the spot market is going to be the best place for our assets to trade in and for us to maximize our cash flow generation. But we always keep an eye out for opportunities. We haven't seen any of late where we thought that it was worth putting vessels out. We feel we can best that performance over the next 12 months by staying spot. But we have done some short-term three-month deals that have outperformed the spot market. So, we're always looking to do things. But in terms of the longer term, 12 months plus type of deals, we don't feel that the market is rewarding us enough for committing the assets at this point in the cycle and that's based on the confidence we have in the spot market going forward.

Ken Hoexter: Great. And I guess maybe to take that one step further, right? The confidence in the orderbook, right? I think it was just mentioned that you're hearing some peers start to place orders. You're still looking at it as historically expensive. Does that fear of the rising eventual orderbook start to pressure your rates in your view? Or is that change your outlook on things as you get more carriers going in and placing orders? Or maybe just walk us through your thoughts on how you see the market panning out.

Kevin Mackay: We recognize that there has been an uptick in ordering in recent months. But our view for the next two to three years is that we're going to enjoy a very strong period of minimal or nonexistent fleet growth. Beyond that, nobody knows. As I said, there has been an uptick when you compare the uptick and an annualized that, probably Christian can jump in later and give us some numbers around it, but when you compare it to previous years or historical norms, the orderbook still isn't large. And as long as that remains the case, we also look at where the fleet profile is for tankers and there is a large grouping of ships that are heading towards 20 years old and beyond that will eventually leave the fleet and when you compare the number of ships on order or that need to be ordered to replace that fleet, that will leave the day-to-day trading fleet. We can take a lot more ordering from here before it really has a large negative impact.

Ken Hoexter: Right. And my last one is just with the OPEC cuts. Do you see any risk of any, I don't know, VLCCs pressing into the, I know it's a different trading market, but any pressure from that fleet pushing into the market? and thanks for the time, guys.

Kevin Mackay: It's a good question. OPEC cuts will definitely impact the Vs because most of the cuts are coming out of Middle Eastern producers. The Vs are naturally going to look for other markets to try and penetrate and we will see them start to move into West Africa. We have, over recent months, seen more VLCC volumes being picked up in the U.S. Gulf going to Europe. But as the Vs struggle for alternate markets, they will start to trade into other areas, which in our view and I think we said this, that could put a sort of a lid on how high the spot market could go in terms of the mid-sized tanker space. But I think overall our confidence is that, especially for the Aframaxes, they're not a vessel that can be replaced readily. And we think that the Aframaxes will continue to enjoy a really strong run. As will the Suezmaxes. It's just that they may be capped out a little bit where the highs don't go as high as we've seen them in the fourth quarter during the summer. But they'll still be on a relative basis, extremely healthy returns for Suezmaxes relative to historical norms.

Ken Hoexter: Great. Appreciate the time and thoughts. Thanks, guys.

Kevin Mackay: Thanks, Ken.

Operator: With that, that does conclude our question-and-answer session. I would like to hand the call back over to the company for any additional or closing remarks.

Kevin Mackay: Thank you for joining us today and we look forward to speaking to you next quarter.

Operator: With that, that does conclude today's call. Thank you for your participation. You may now disconnect.