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

Company: Teekay Tankers Ltd.

Date: Thursday, 3rd August 2023

Conference Time: 11:00 ET

Operator: Welcome to Teekay Tankers Limited Second Quarter 2023 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 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.

Ed: Before we begin, I would like to direct all participants to our website at www.teekay.com where you'll find a copy of the second 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 second quarter 2023 earnings release and earnings presentation available on our website. I'll 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 second 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 in slide three of the presentation, Teekay Tankers generated total adjusted EBITDA of approximately $185 million in the second quarter more than triple the $58 million we generated in the same quarter of last year. We reported adjusted net income of $149 million, or $4.38 per share, almost six times last year's second quarter levels of $25.7 million, or $0.76 per share, respectively.

As a reminder, given our high operating leverage, for every $5,000 increase in day rates above our free cash flow breakeven of $16,000 per day, we expect to generate approximately $2.60 of annual free cash flow per

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share. Our second-quarter results reflect this high operating leverage as our owned fleet and eight vessels chartered-in fleet generated a total of $170 million of free cash flow.

In line with our fixed quarterly dividend policy announced last quarter, we have declared a cash of $0.25 per share for the second quarter of 2023.

We have also continued to exercise purchase options on sale-leaseback vessels, in this case giving notice on an additional four vessels for $57 million. As previously mentioned, we'll be refinancing these vessels with our $350 million revolving credit facility. Once repurchased in September, these four vessels will bring our total sale-leaseback repurchases to 19 vessels and $365 million since March of 2023, reducing our interest expense and giving us the ability to better manage cash and debt balances.

In the market we show very strong spot rates for mid-sized tankers in the second quarter driven by strong Chinese and Indian oil imports, as well as, firm oil exports from both Russia and the United States. As we have moved into the third quarter, we have seen quarter-to-date spot rates following their normal seasonal pattern while remaining well above historical levels for this time of the year. We continue to believe that tanker supply and demand fundamentals are positioning the market well for both the coming winter and potentially for an extended period thereafter.

Finally, we extended two chartered-in vessels for an additional 12 months each at an average rate of $20,600 per day while also securing a further 12-month option on one vessel at what we believe is an attractive rate. This takes our average in-charter rate for eight vessels to $25,000 per day. We remain active in managing a time charter book that has generated substantial incremental earnings and free cash flow, including approximately $18 million in Q2 this year.

Turning to slide four, we look at recent developments in spot tanker market. As noted, spot tanker rates remain very strong during the second quarter. This was due to a combination of strong Indian and Chinese crude oil imports; an increase in Russian crude oil exports that reached a three-year high with the majority of volumes moving long-haul to India and China; and high export volumes from the US Gulf with a large proportion continuing to be transported on mid-size tankers to Europe.

As is typical at this time of year spot rates have moderated in Q3 to-date, primarily due to seasonal factors. As an example, we have observed that Russian crude oil export volumes have decreased in the past few weeks, which we believe is due to an increase in Russian refinery throughput to meet summer demand leaving less crude oil available for export. However, it's important to note that seasonally lower spot rates thus far in Q3 remaining well above historic levels as shown by the chart. The red dots in the chart indicate our prior third-quarter earnings and show the current quarter averaging well above any third quarter seen in the last decade. In fact, rates in the quarter to date are higher than any quarter in the past decade with the exception of the most recent winter.

As shown by chart, over the last 10 years the seasonal dip in rates which is typically observed during Q3 has almost always reversed during Q4; and given the Tanker market fundamentals we expect this year to follow the same pattern. As we move into the fourth quarter, the onset of winter seasonal factors coupled with rising oil demand through the second half of the year should lead to even more favorable conditions than in the third quarter to the date leading to another firm winter Tanker market.

Turning to slide five, we provide an update on our Suezmax, Aframax spot rates in the third quarter to-date. Average third quarter-to-date rates have been historically strong. Based on approximately 48% and 44% of revenue days booked Teekay Tankers third quarters to-date Suezmax and Aframax vessel bookings have averaged approximately $42,800 per day and $48,300 per day, respectively, in both instances well above the strong third quarter of 2022 spot rates. While current spot markets rates have decreased from these very firm quarter to-date levels, rate rate volatility is expected, particularly in periods of market strength.

Importantly, I would highlight the value being created by TNK's eight vessel chartered-in fleet given the continued market strength. With an average rate of $25,000 per day and six vessels trading in the spot market the chartered-in fleet has a current market-to-market value of approximately $64 million.

Turning to slide six, we look at some of the fundamental factors which we believe will continue to support a strong tanker market over the next two to three years. Starting in the left column, global oil demand remains very robust driven by non-OECD countries and in particular China due to a rebound in travel and petrochemical demand following the removal of COVID-19 restrictions. As per the IEA, global oil demand is set to increase by 2.2 million barrels per day this year to a record high of just over 102 million barrels per day, with further growth of 1.2 million barrels per day projected for 2024. While production from the OPEC+ group is uncertain, supply from non-OPEC nations continues to grow. Most of this growth is from Atlantic Basin producers such as the United States, Brazil, and Guyana. Given that demand growth is concentrated in the Asia Pacific region, an increase in long-haul movements from the Atlantic to Pacific should be a positive driver of tanker tonne-mile demand over the medium term.

In the middle, we show average voyage distances continue to increase due to changing trade patterns as a result of Russia's invasion of Ukraine in early 2022. Since the EU ban on Russian oil import was introduced late last year, approximately 90% of all Russian crude oil exports have been moving long haul to India and China. Given that VLCCs cannot load directly from Russian ports this change has primarily benefited the Aframax and Suezmax sector. Although TNK does not carry Russian oil, overall Suezmax and Aframax size vessels have benefited from a 14% increase in voyage distances since the start of last year. Importantly, we expect these trade pattern changes to be durable meaning continued support from mid-sized tanker demand for the foreseeable future.

Finally, fleet supply fundamentals continue to look very positive with the tanker orderbook remaining at historic lows of around 5% of the existing tanker fleet. Although this year has seen an increase in tanker ordering when compared to low levels of last year, 2023 ordering is actually in line with the 10-year average. Furthermore, the tanker orderbook is still small compared to the fleet of older vessels that may be phased out in a few years, meaning that fleet growth should remain low over the medium term. With shipyard capacity now largely sold out for 2025 deliveries, low fleet growth over the medium term is all but set with approximately 2% fleet growth expected in this year and close to zero fleet growth in both 2024 and 2025.

In sum, we retain our positive outlook for tanker rates over the next two to three years and believe that the factors which are supporting this upturn are durable in nature. This is in contrast to recent market upturns, such as in early 2020, which we've given by more short-term and transitory factors. I'll now turn the call over to Stewart to cover the financial slide.

Stewart Andrade: Thanks, Kevin. Turning to slide seven, we highlight the significant shareholder value Teekay Tankers has created over the last 12 months and how well we are positioned to continue creating shareholder value. With 96% of our 53 vessel fleet trading in the spot market the combination of TNK's high operating leverage and a firm spot market has demonstrated our ability to generate substantial free cash flow in recent quarters. As an illustration of that, over the past four quarters the company has generated over $600 million or $17.62 per share of free cash flow. Looking forward, if the Q2-2023 spot rates were achieved on average over the next four quarters we would expect to generate a total of about $19.50 per share in free cash flow. This equates to a free cash flow yield of approximately 45%.

With our continued strong cash flows in the second quarter, we decreased our net debt by $153 million to just $28.5 million. Given the continued strength in the tanker market in the first part of the third quarter we are now net debt free, further supporting our ability to reinvest in the TNK fleet when the time is right and to return capital to our shareholders. However, we still have obligations related to sale-leaseback financings totaling approximately $210 million, $57 million of which we will repay when we acquire four tankers in September, with purchase options on the remaining eight vessels under sale-leaseback arrangements available in Q1-2024.

I'll now turn the call back to Kevin to conclude.

Kevin Mackay: Thanks, Stewart. In summary, our discipline in capital allocation and the strong markets for mid-sized tankers have enabled us to build Teekay Tankers balance sheet into excellent condition. Our fleet of spot market-employed mid-size tankers positions us well to generate a great deal of free cash flow moving forward as sustainable multi-year fundamentals support a tight mid-size tanker market. We'll remain disciplined in deploying that cash under our capital allocation policy, and we believe that we are set up well to drive significant shareholder value creation. With that, Operator, we're now available to take questions.

Operator: 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, please press star one to ask a question.

Our first question comes from the line of Jon Chappel or Chappell with Evercore ISI.

Jon Chappell: Thank you. Good afternoon or good morning. Stewart, if I can start where you left off, and you probably anticipated already because you already partially answered it, but with the rest of the sale-leasebacks coming up in the first quarter, you know, having a pretty good line of sight on what that spend will be and being net debt free today, do you anticipate saving up capital for that 1Q event where you can really clear the decks on the sale and leaseback? Or if there is a seasonal uplift let's say starting in the fourth quarter, does that make that not really mutually exclusive with ratcheting up either a special dividend or maybe the base dividend?

Stewart Andrade: Thanks, Jon. I think at this point, as you said, we've got good visibility on the two remaining groups of purchase options which in total are about $200 million. I don't think that's moving the needle significantly in terms of our near-term thinking on the dividends. We announced just last quarter a change to our capital allocation policy of $0.25 per quarter. I don't think you're going to see a change to that in the near term, it’s something that we continue to think about but I wouldn't expect to see a change to that in the near term.

As you know, we've decided that we will use special dividends as the avenue for returning extra capital to shareholders and or using the share buyback program which we announced last quarter. But that's something that we're going to look at on a more periodic basis, not something that we'll be doing on a quarter-to-quarter basis. So I think we'll probably wait to see how the next few quarters unfold and then make a call in terms of what we want to do on that side of things.

Jon Chappell: Okay, thank you. And then Kevin, good job laying out the market outlook, or maybe this is even for Christian too. Seasonality has come up a fair amount as expected we have a long history of that; however, I was just reading about with the Urals breaking the price cap of $60 per barrel, maybe some more disruption to the mid-size fleet and maybe in a not favorable manner of vessels that were trading Russian crude still within compliance of the sanctions now being fearful of violating those and coming back in the main trade lanes and maybe putting some pressure on. Have you seen any of that yet? Does that really impact at all kind of your near-term view on supply-demand within your two core segments?

Kevin Mackay: Hey, Jon. We have seen it obviously going into the current spot market. Right now we have seen Europe and US Gulf come off quite significantly versus the Far East which is still holding up at $30,000 a day. I think some of that is a function of the drop in supply of Russian oil which I think, Christian could probably confirm this, but I think we've seen about a 20% drop in Russian oil export since May. That is more oil is driven towards the refining sector rather than the export market.

But I think also with the price cap breach, TNK doesn't participate in that trade. But from what we're picking up from people who do, there are still the ability to load Urals crude, for example, provided they get the attestation. Some owners have indicated they are getting those attestations still. Having said that, we have seen an increase in the tonnage lists as a number of players who did participate in that obviously haven't been able to get the attestation from their customers and they're now returning to our trade which is putting some pressure on the immediate spot rates. I think as we move forward, we'll see the volumes pick back up as the working refineries going into maintenance in the fall. So that should be supportive as we get into the fourth quarter as we see more export volume picking up.

Jon Chappell: That's very helpful. Thank you, Kevin. Thanks, Stewart.

Stewart Andrade: Thanks, Jon.

Kevin Mackay: Thanks, Jon.

Operator: We'll go next to Omar Nokta with Jeffries.

Omar Nokta: Thank you. Hey, Kevin and Stewart. Good morning. Sort of looking to follow up a little bit on the balance sheet. Obviously, cash flow is coming in in large amounts and deleveraging pretty quickly, and as you mentioned Stewart you're in a net cash position. I guess maybe first question on this is you've exercised the four shifts for the $57 million, do you plan to utilize the $350 million facility to sort of finance that purchase or do you really want to focus on just using cash to buy those out?

Stewart Andrade: Hi, Omar. Thanks for the question. It will depend on how the next quarter or for the first purchase options in September will depend on how the next quarter goes. Then for the others in Q1 again it'll depend on how much cash flow we generate. Whether we use cash on hand or need to draw on that revolver in order to finance those is more like a near-term cash flow consideration as opposed to a significant decision. I guess it just depends on if we have sufficient cash in the bank to make those repayments. The vessels we are repurchasing will go into that facility. And they will form this part of the security for that facility. So we've prearranged it so those vessels will go in there. But whether we need to draw to it in order to make that repurchase or not will just depend on the spot market.

Omar Nokta: Okay. Yeah, I was just sort of trying to figure because obviously depending on how the freight market goes from here it looks like you could exercise those options with cash and leave that facility alone and then you've got the $200 million that you were mentioning that you could exercise next year, you could probably do that with cash as well. And so just wondering is it an aim of yours to get the balance sheet to completely debt free? You've eliminated the bank debt, you still have the lease debt, can you envision is it a goal of yours to take both the bank and the lease debt to zero and still have a bit of cash on the balance sheet?

Stewart Andrade: Yeah, we haven't made a final decision on whether we're going to exercise the purchase options on the vessels in Q1. As I said, they are available and that's about $150 million. We haven't made that decision yet, but we may do that, and if we do we would envision being completely debt free with cash on the balance sheet.

As we outlined when we introduced the capital allocation policy last quarter. And just to remind everybody, our number one priority is to build capacity for making reinvestments in the fleet at the right time when the opportunities arise and that is one of the things that we're focused on. We haven't acquired a tanker since 2017, so it's been quite a long time. We've been focused on being disciplined and getting our balance sheet in order. But as a result, we do have significant investments that we could make if the opportunities arise. We're really trying to prepare ourselves for that. The reason that we're generating all of this cash flow at the moment is because we have 53 vessels trading because we made investments in our tanker fleet in the past. Our view, and for the long-term value creation for shareholders, is that we need to reinvest. We're going to do that in a disciplined way when the opportunities arise.

Omar Nokta: Okay. Thank you. That makes sense. I guess we'll see how those opportunities start to play out. One final follow-up, just back to the debt I saw in the release you mentioned that you've terminated or cancelled a $65 million credit facility that was due to mature next year. It was undrawn. Wondering out of curiosity what was the reasoning for terminating that?

Stewart Andrade: Yeah, given our liquidity at the end of Q2 which you saw is over $600 million. We didn't really have the need for the extra liquidity that that facility provided to us. Of course, all revolving credit facilities or our revolving credit facilities in any case have a carrying cost. It was just really an optimization decision to avoid the cost of having that extra availability when we don't really need it and we're accumulating cash flow quite quickly from operations. So really an optimization decision.

Omar Nokta: Got it. Okay. Thank you. That's helpful. I'll turn it over.

Stewart Andrade: Thank you.

Operator: We'll go next to Ken Hoexter with Bank of America.

Nathan Ho: Hey, this is Nathan Ho dialing in for Ken. I just have a quick housekeeping question. First, I see in the presentation there's a slight pickup in your free cash flow break-even TCEs to $16,000 from $15,000 last quarter. This is in spite of some pretty impressive de-leveraging moves. Could you maybe just walk me through the math there on what's driving that slight increase?

Stewart Andrade: Hi, Nathan. Thanks for the question. I don't have a breakdown of the fine detail on that. But the big picture reason for the increases that we've extended some time charters at incrementally higher rates than we had previously. So our average in-charter rate is now about $25,000 a day which is obviously very compelling versus current freight markets. So makes a lot of sense to be extending those time charters. But some of them are at incrementally higher rates than there were before and that's the primary driver behind the increase in the break-evens. We can take it offline to help you to bridge that specifically if you'd like.

Nathan Ho: Got it. Okay. That's super helpful. And maybe continuing on that point, it sounds like a lot of the capital decisions seem to be a little contingent on how the spot market performs. And an impressive $64 million mark to market on the chartering contracts. Could we anticipate some actualizations of those mark-to-market gains? As in could we possibly see a slight increase in the time charter exposure or a slight decrease in the 96% spot exposure?

Kevin Mackay: We said this on calls in the past we're always keeping an eye on the spot market relative to the time charter market or vice versa. On our in-charter fleet we have eight and we actually made the decision several quarters ago to put a couple of them out. And lock in that margin and crystallize the gain on those. Similarly, with our fleet as opportunities arise we will compare them with what we think our forward view of spot market is and if the opportunity is compelling and adds more value we'll lock in that. It's not something that we strategize to set a target on, it's more opportunistic, and it's always reflective of what gives us the best return over that period of time spot versus time charter.

Nathan Ho: Got it. That's clear. Thank you very much.

Kevin Mackay: Thank you.

Operator: There are no other questions at this time.

Kevin Mackay: Thank you very much for joining us. We look forward to speaking with you again next quarter. Goodbye.

Operator: This does conclude today's conference call. Thank you for your participation, you may now disconnect.