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

Company: Teekay Tankers Ltd.

Date: Thursday, 2nd November 2023

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

Operator: Welcome to the Teekay Tankers Ltd Third 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 this 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 telephone. 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 Lee: Before we begin, I would like to direct all participants to our website www.teekay.com, where you will find a copy of the third 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 third 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' third 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 $106 million in the third quarter, up from the $92 million we generated in the same quarter of last year. We reported adjusted net income of approximately $77 million or $2.24 per share, an increase from last year's third quarter levels of $58 million or $1.70 per share respectively. Our significant operating leverage combined with the historical high third quarter spot rates resulted in Teekay Tankers generating our highest ever third quarter adjusted net income.

As a reminder for every $5,000 increase in Tanker rates above our free cashflow breakeven of $16,000 per day, we expect to generate approximately $2.60 of annual free cashflow per share. We'll provide further information of this later in the presentation.

In line with our fixed quarterly dividend policy, we have declared a cash dividend of 25 cents per share for the third quarter of 2023.

As previously announced, we completed the repurchase of four vessels, which were on sale leaseback arrangements for $57 million. These vessels were financed with our $350 million revolving credit facility.

In the market, rates remain firm on a historical basis with average mid-size rates the highest for a third quarter in 15 years. These high average spot rates were achieved despite spot tanker rates declining in the second half of the quarter due to a combination of reduced exports from OPEC plus and normal seasonality. Spot tanker rates have, however, firmed significantly once again through the early part of the fourth quarter and we believe the increased Tanker demand and seasonal factors will continue to support rates through the winter months. While seasonality and geographical factors will continue to play a role, tanker market fundamentals point to continued strength over the next two to three years underpinned by a very positive fleet supply outlook.

Finally, we extended one in-charter vessel for an additional 12 months at a rate of $21,250 per day. Our in-charter fleet of eight vessels now has an average charter in rate of $25,400 per day, and the company also has two vessels chartered-out and an average of $43,500 per day.

Turning to slide four, we look at third quarter dynamics in the spot tanker market. Spot tanker rates remained historically firm during the third quarter. The rates fell during the second half of the quarter due to reduced exports from the OPEC+ group and normal seasonality.

Saudi Arabia announced a voluntary supply cut of a million barrels a day in July, 2023, and has pledged to keep these cuts in place to the end of the year, which has negatively impacted crude Tanker demand for larger ships. In addition, Russian crude oil exports fell during the third quarter as higher Russian domestic demand during the summer resulted in less crude oil available for export. Seasonal factors also played a part with lower crude demand from refineries during the quarter due to normal seasonal maintenance. Despite these factors, tanker rate averages remain firm on a historical basis with TNK recording the best mid-size tanker spot rates for a third quarter in the past 15 years.

At the start of Q4, Spot Tanker rates have increased sharply as seaborne crude oil volumes have increased as shown by the chart on the right of the slide. We believe that this marks the start of the seasonally strong winter market and we'll give more detail of our outlook for the coming months later in the presentation.

Turning to slide five, we provide an update on our Suezmax and Aframax size spot rates in the third quarter to date. Based on approximately 42% and 37% of revenue dates booked, Teekay Tankers third quarter to date, Suezmax and Aframax size vessel bookings have averaged approximately $26,500 per day and $38,800 per day respectively.

As you'll see from the green dots on the chart, the current reported rates from Clarkson’s are now sharply higher, which speaks to the tightness in the tanker market and the effect of increased seaborne crude volumes. As voyages agreed during the latter part of Q3 and early October are completed and replaced by

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those reflecting the more recent higher spot market. We expect our own spot rate results to strengthen as we move further through the quarter, provided rates remain firm.

Importantly, I would highlight the value being created by TNK's eight vessel chartered-in fleet with six trading in strong spot market. With an average in-charter rate of $25,400 per day, the chartered in fleet has a current mark-to-market value of approximately $56 million.

Turning to slide six, we look at our outlook for the upcoming winter tanker market. As mentioned earlier, spot tanker rates have risen sharply at the start of the fourth quarter. One of the main drivers has been an increase in crude oil exports from key load regions, including a reversal of supply cuts from both Russia and Saudi Arabia. As shown by the chart on the left, Russian crude oil exports have recovered from a low of 3.1 million barrels per day in July to 3.5 million barrels per day in October. With over 90% of these volumes heading long haul to India and China on Aframaxs and Suezmaxs, this increase has resulted in their turn of significant mid-size tanker demand as we saw earlier in the year.

Similarly, crude oil exports from Saudi Arabia have increased from a low of 5.5 million barrels per day in August to an average of 6.5 million barrels per day in October. This increase comes despite Saudi Arabia's voluntary production cut of 1 million barrels per day remaining in place as lower domestic demand and refinery maintenance have made more oil available for export.

Crude oil exports have also been strong from other key mid-sized Tanker load regions, such as the US Gulf and West Africa. The removal of US sanctions on the Venezuelan oil industry could give a further boost in the coming months as more oil is expected to flow the US and Europe on mainstream Aframax and Suezmax tonnage at the expense of movements to China on the dark fleet.

Higher refinery throughput should also support crude Tanker demand in the coming months as refiners increase their crude purchases ahead of the winter demand season. As shown by the chart, the IEA expects the global refinery throughput will increase by 2.4 million barrels per day between October and December, which should be positive for Tanker demand. Normal winter market factors such as weather delays are expected to give further support to rates by tightening available vessel supply as is normal during the fourth and first quarters of the year.

Turning to slide seven, we highlight the positive Tanker supply fundamentals, which we believe will underpin a strong Tanker market over the next two to three years.

Firstly, the tanker orderbook remains close to historic lows at just under 6% of the existing tanker fleet size. As per Clarksons, global shipyard forward cover currently stands at three and a half years, the highest level since 2009 with 90% of the orderbook comprising vessels other than tankers. This means that the delivery of the small tanker orderbook will be spread out over a longer than normal period and that there are limited births available for additional deliveries prior to 2027.

While we acknowledge that pace of tanker ordering has increased in 2023 compared to last year's historical low levels, this increase needs to be put into context. Just under 24 million deadweight tons of new tanker orders has been placed to-date during 2023, which is in line with the average level of newbuild ordering over the last 20 years. Furthermore, the tanker fleet is aging with a significant portion of the fleet reaching potential replacement age in the next few years. At present, 11% of the mid-sized tanker fleet is aged 20 years or older with another 14% reaching age 20 between 2024 and 2026.

A combination of a smaller tanker orderbook, an aging tanker fleet, and a lack of shipyard capacity are expected to lead to very low levels of tanker fleet growth for at least the next two to three years. Using our internal ship supply forecast model, which is based on the current order book and assumes very conservative levels of ship recycling, we project that less than 1% fleet growth in 2024 and 2025 and negative fleet growth in 2026.

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

Stewart Andrade: Thanks, Kevin. Turning to slide eight, we highlight the significant shareholder value and increasingly strategic optionality being created by Teekay Tankers. With almost all of TNK's 53 vessel fleet trading in the firm spot market, our high operating leverage once again enabled us to generate substantial free cash flow. In the third quarter, which had seasonally lower rates, particularly in August, we generated $98 million of free cash flow. If Q3-2023 spot rates are forecast for the next 12 months, we would expect to generate about $350 million in annual free cash flow or $10.25 cents per share annually equating to a free cash flow yield of approximately 20%. Generating almost $100 million of shareholder value in the seasonally weakest quarter of the year, clearly demonstrates how well Teekay Tankers is positioned to create value in this market.

Considering a full year of spot rates, the chart on the slide also shows our forecast annual free cash flow based on average spot rates achieved by Teekay Tankers in the last 12 months. With these rates, TNK is forecast to generate over $18 per share of annual free cash flow equating to a free cash flow yield of approximately 36%. With the tanker market now in its sixth consecutive strong quarter, and with the market fundamentals pointing towards sustained strong market, we believe the company is very well positioned to continue creating shareholder value and strategic optionality.

In terms of our financial position, we have leveraged our strong cash flow generation and our increasing financial strength to further optimize our balance sheet. Since March of this year, we have repurchased 19 vessels from sale leasebacks for total of $364 million. Refinancing these vessels into a revolving loan facility has allowed us to maintain readily available capacity to take advantage of opportunities while paying down debt balances and reducing interest expense.

In addition, given our financial position, we elected to terminate our $80 million working capital loan facility. These steps have allowed us to further reduce our breakeven levels and increase value creation for our shareholders.

Looking forward, we have eight vessels remaining in sale leaseback arrangements for which we have purchased options totaling $137 million available beginning in the first quarter of 2024. While still dependent on market conditions, we anticipate exercising those options and completing that phase of our balance sheet optimization.

Finally, as mentioned on the last call, we're in net cash position, which reached $83 million at the end of the third quarter. I will now turn the call back to Kevin to conclude.

Kevin Mackay: Thanks, Stewart. In summary, with Vessel fleet growth that is essentially fixed at a very manageable level for the next few years, we see the potential for a strong and healthy extended run for the overall tanker market and for Teekay Tankers in particular. Our spot market exposure, strong financial position, and focused participation in the mid-size crude segment is, in our view, putting us in a very good position over the next few years to capture both opportunities and added value for our company. With that operator, we're now available to take questions.

Operator: And if anyone 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's turned off to allow your signal to reach our equipment. A voice prompt on the phone line will indicate when your line is open. Please state your name before posing your question.

Again, it is star one to ask a question and we'll pause for a moment to allow everyone an opportunity to signal for questions. Our first question is coming from John Chappelle with Evercore.

Jon Chappell: Thank you. Good morning or good afternoon. Stewart, if I can start where you left off on the creating significant shareholder value and strategic optionality. Should we think about this Q1-24 eight remaining vessels on sale-leaseback, kind of the clearing event? You've generated a ton of cash, the net cash positions continue to move up. The most delevered balance sheet in the industry, one special dividend, but maybe how do we think about capital allocation going forward? Do we just have to finalize this one last piece of the balance sheet restructure, and then we can think about capital returns being ratcheted up?

Stewart Andrade: Hi, John, thanks for the question. I see the final sale leasebacks and acquiring those as really an incremental step in terms of optimizing the balance sheet and not really a major event. It's just a progression. As we've said in our prepared remarks, we're in a net cash position and that's not going to change significantly when we purchase those vessels back.

We came out with the capital allocation plan six months ago, which as you know included a fixed dividend. When we announced it, we also paid a $1 special dividend and we put a share buyback program in place. I would say in broad terms that the market has unfolded roughly in line with what we expected when we put that in. We've been very bullish on the tanker market and it's delivered over the last six months, so I don't see any change in our capital allocation in the near term. Of course, we understand that shareholders are interested in a return of capital, and we have the tools in place to do that. Anything above our quarterly fixed dividend will be subject to discussions that we have with our board and making decisions to return anything in addition to the 25 cents a quarter. When we announced the policy, if you recall, we said that that's something that we would likely do on a periodic basis and that's still our plan going forward.

Jon Chappell: Okay, thank you. And then just follow up to Kevin on strategic optionality. So, asset values continue to move higher. You've just laid out a very optimistic view on the market for the next two to three years, which would make me think that there's more willing buyers and willing sellers have continue to put upward pressure on asset values. When you think about the modernization of your fleet, could you also consider, and I think I asked this in a different way last quarter, so forgive me, but could you modernize the fleet by selling older tonnage at pretty premium prices as opposed to what I think as some people fear is a rock and a hard place of going out and buying a assets at a peak?

Kevin Mackay: It’s an arithmetic question. If you sell older assets, your average fleet edge comes down. The way we look at it is, what is the best thing to do with our fleet? And at this point in time, we're extremely comfortable with where our fleet stands today. It's in line with industry average profiles. It's in a fantastic segment in the mid-size tanker space and we're benefiting from the tonne-mile increases as a result of Europe banning the Russian imports. But there's a lot going on right now, and in our view, there's really no rush to do anything.

We're really in a good position, so our forward view of the market is strong. We can continue to trade our assets for several years into the future without any difficulty.

As you've mentioned, we could also sell, and with asset prices being high, we keep our options open. If we're offered a very nice opportunity to sell an asset and add incremental value above what our forward expectations are, we'll obviously consider that. But it's really a portfolio view that we take on the fleet and with the strategy that we have, I don't see the need right now to pull the trigger to do anything immediately.

Jon Chappell: Okay. I appreciate it. Thank you, Kevin. Thanks, Stewart.

Kevin Mackay: Thanks, John.

Operator: Our next question coming from Omar Nokta with Jefferies, your line's open.

Omar Nokta: Thank you. Hi, Kevin Stewart. Good morning. Yeah, just following up I guess on Jon's line of questioning and also kind of basically the same topic that seems to come up each quarter is yeah, just indeed the thought process or kind of what, what your strategic plans are longer term, I guess Kevin, you pretty much out laid it out there that you're comfortable, you've got the fleet you want. It's generating a good amount of cash, especially in today's market but you don't feel the pinch to go out and do anything in terms of acquiring assets. Then you mentioned if somebody were to present you with an offer on some ships, you'd be happy to entertain it if it was good enough.

I guess in the bigger picture grand scheme, when you think of, say, Teekay Tankers going forward, would you characterize it as perhaps maybe a, like a closed end fund where you're generating strong returns, you're giving it right now you're paying down debt and strengthening the balance sheet, but do you see it evolving to where it just, it becomes a capital return story and then eventually selling the company altogether?

Kevin Mackay: I think the way we look at it, Omar, is we've put ourselves in a very good position. We have a fleet that is facing a very strong market, and we believe we've got the fleet that's in the sweet spot in the tanker space, the mid-size tankers. We're benefiting from what is going on in the world right now and the durable ton miles that have increased significantly. The industry's fleet profile is aging, and Teekay Tankers is no different in this. There is a need to do fleet renewal at some point. But we also feel that there's no need to rush into that. We've got time.

And yes, we can sell some of our older assets and we may do so. But in the meantime, we want to try and maximize our exposure to the strength of this market and keep ships bringing in rates that we're getting today at $70,000 a day that is adding shareholder value in our view.

So in the future, we'll deal with what comes our way, but for now it's really around maximizing the potential of the fleet we've got before we take any further steps to rejuvenate it.

Stewart Andrade: Maybe just following up on that a little bit, Omar, if we were viewing it as a closed end fund, I think you'd see us being a significant dividend payer and distributing the capital that we're generating. We're not doing that, we're holding onto the capital and creating capacity to reinvest in the fleet. That wasn't in our prepared remarks this quarter, but certainly last quarter that our focus is putting ourselves in a position to reinvest when the time is right and in an investment that we think will be a creative and, and add value for our shareholders.

Omar Nokta: Okay. Thanks, Stewart and Kevin, that's helpful. And you've been on this plan for perhaps maybe four or five years where you really focused on the leveraging you went from a very high leverage ratio to now net cash, and so you've been playing the long game here.

I guess this is basically what's happened is you've taken advantage of a strong market to delever, you've gotten yourself in a great financial position, you're now harvesting all the excess cash flow and just enjoying it providing you a tremendous flexibility. But in terms of looking to invest, it's basically you just need to wait for perhaps to get the next step, the next part of the cycle. Whether that takes two years or three years of, if we're in this Tanker market upswing that lasts to say 2025, 2026, can we just expect Teekay Tankers to just hang back, generate that cash flow, build up a nice cash cushion, and then once the cycle turns, that's when we're going to deploy capital in a different manner.

Stewart Andrade: I don't think it's that binary, Omar. I think that there are opportunities arise at different times. We always are evaluating opportunities for investment, whether that's in one vessel, a fleet of vessels or what have you. So yeah, so our view is that it's not that binary and we're always looking for ways to do deals that can create value and we will continue to do that. I guess our message is that we are being disciplined and we'll only do deals that we think will create shareholder value.

Omar Nokta: Thank you. Thanks Stewart. That's clear. I'll turn it over. Thanks again Kevin.

Kevin Mackay: Thanks Omar.

Operator: Our next question is coming from Ken Hoexter with Bank of America. Your line's open.

Nathan Ho: Hey, hi, this is Nathan Ho dialing in for Ken Hoexter. Congratulations on the great results. I guess I just wanted to follow this train of thought on the long game that Teekay Tankers is playing here. Many times, over the call it's been referenced that rates are currently historically strong and with Afra and Suez rates here in the 70s and the 80s. I guess I just, I'm curious as to what management is thinking about spot exposure over the long term. As in, I understand that the spot fundamentals are still very much intact, but are there any considerations and bring that 96 maybe down into, say like the 80s or the 70s? Maybe talk a little bit about demand for longer term charters from some of the charters out there.

Kevin Mackay: Sure, Nathan, it's a good question actually, actually. At the moment we're about 96% exposed to the spot market. We're confident that the fundamentals are there for this spot market to continue at these sorts of levels we've been seeing this year. Really, in our view, it makes more sense to be more spot exposed say than to start locking in in time charters.

If you look at the forward order book that supports the longer view, that's why we want to be incrementally more exposed to the spot market. Having said that, and I've said this almost on every call, every quarter, we always on a daily basis keep our eyes open on the time charter market, both to out-charter or to in-charter. And if we see opportunities where a customer is willing to give us fixed rate employment for a year or a number of years at rate levels that we find so attractive, then we will deploy that ship to that customer and do those deals.

Similarly, if we find an owner who is willing to give up a ship at a rate where we feel we can make a margin by trading that ship into our fleet in the spot market, you'll see us take ships as we've done with the eight-ship fleet that we've been chartered over the last 18 months.

It's not a mathematical equation, it's more of a sense of where we think opportunity lies and at the moment, we feel that having a higher percentage of our fleet in the spot market is where we're going to generate the most value. But as I said, that gets evaluated on a daily basis and it could change as we move forward, a lot depends on the opportunities that get presented to us.

Nathan Ho: Great. That's really helpful. Thanks, Kevin. Yeah, like the, the $21,000, $22,000 per day charter in that was very well done. Just to follow up a little bit more on the sale leaseback side of things. Clearly interest rates are rising, which I'm sure was an offset, but maybe Stewart, could you just remind us again on the financing benefits from the repurchase this quarter as well as the one in Q1-24? Thank you.

Stewart Andrade: Sure. So this quarter we repurchased four vessels, which were on sale leaseback for about $57 million. Those had been on leases which were at LIBOR plus or SOFR plus 285. And we have eight vessels that we can repurchase in Q1 of next year. The purchase option price on those is about $137 million, and those are currently at SOFR plus 275. So about both of those were effectively 8.4% interest we were paying on those. So that's what we purchased back and we'll be purchasing back in Q1.

All told for 2023 and Q1 of 2024, there'll be a total of $532 million of leases that we will have bought back. And that's probably in the neighborhood about $20 million a year interest savings in terms of the optimization from doing that instead of carrying those leases. Perfect.

Nathan Ho: Thank you so much.

Stewart Andrade: You're welcome.

Operator: And there are no further questions at this time. I would like to turn the conference back to you 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: This concludes today's call. Thank you for your participation, you may now disconnect.