TEEKAY TANKERS' FIRST QUARTER 2017 EARNINGS RESULTS

Conference Call Transcript

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Operator: Thank you for standing by, and welcome to Teekay Tankers Limited's First Quarter 2017 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, today's call is being recorded. Now, for opening remarks and introductions, I would like to turn the call over to Mr Kevin Mackay, Teekay Tankers Limited's Chief Executive Officer. Please, go ahead sir.

Ryan: Before Kevin begins, I would like to direct all participants to our website at www.teekaytankers.com where you will find a copy of the first quarter 2017 earnings presentation. Kevin 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 statement is contained in the first quarter of 2017 earnings release and earnings presentation available on our website. I will now turn the call over to Kevin to begin.

Kevin Mackay: Thank you Ryan, hello everyone and thank you very much for joining us today. With me here in Vancouver are Vince Lok, Teekay Tankers Chief Financial Officer, and Christian Waldegrave, Head of Strategic Research at Teekay Corporation. During today's call, I will be taking you through Teekay Tankers' first quarter 2017 earnings results presentation which can be found on our website. Beginning with our recent highlights on slide three of the presentation, Teekay tankers reported adjusted net income of $7 million or $0.04 per share in the first quarter of 2017, compared to adjusted net income of $5.1 million or $0.03 per share in the fourth quarter of 2016. We generated a free cash flow of $34.4 million during the quarter, which was consistent with the previous quarter. While spot[?] tanker rates were largely in line with those for the fourth quarter of 2016, the tanker market experienced downward pressure over the course of the recent quarter, due to various factors which I will touch on in more detail on the next slide.

In accordance with our dividend policy, Teekay Tankers declared a dividend of $0.03 per share for the first quarter of 2017, representing the minimum quarterly dividend. In addition to the strong cash flows generated from operations during the quarter, we are continuing to focus on further strengthening our balance sheet. In April, Teekay Tankers signed a term sheet for $153 million 12 year sale leaseback financing transaction for four of our modern Suezmax tankers. Once finalised, this transaction is expected to increase our liquidity position by approximately $30 million, strengthening our financial positioning, while maintaining our exposure to what we anticipate will be a tanker market upturn in 2018. This transaction which is subject to final lessor approval and customary closing conditions is expected to be completed by mid summer. Further, we completed the sale and delivery of two 2002 built Suezmax tankers for total combined proceeds of $31.6 million, and have agreed to sell a 1999 built Aframax tanker for proceeds of $7.5 million, which is scheduled to deliver to buyers in late May or early June. Lastly, Teekay Tankers secured a 12-month paying charter for one of our Suezmax tankers at a daily rate of $21,000, which commenced in early April of this year.

Turning to slide four, we look at developments in the crude tanker spot market in the recent quarter. As the chart on the slide illustrates, mid-sized crude tanker rates for the first quarter of 2017 were the lowest first quarter rates since 2013. Freight rates softened over the course of the first quarter due to the impact of OPEC supply cuts, higher fleet growth, and seasonal refinery maintenance. However, rates remained above 2013 levels, as a decline in Middle East to Asian movements, due to the OPEC supply cuts, encouraged an increase in ton-mile intensive Atlantic base into Asia movements, which helped to offset some of this weakness. Since the start of the year, OPEC cuts have taken around 1.2 million barrels per day of oil production offline in an effort to rebalance oil prices. Compliance with these cuts across OPEC producers has been high, with most cuts coming from Saudi Arabia. While production cuts are negative for the overall volume of crude oil available for transport, midsized segments have found some support from an increase in changing trade patterns and subsequent growth in long haul exports to Asia, as suppliers look to replace lost OPEC barrels.

Spot tanker rates continued to soften at the start of the second quarter, as a period of higher fleet growth and refinery maintenance in Asia, on top of the ongoing supply cuts, have put further downward pressure on fleet utilisation. However, we believe that there is the potential sum rate volatility as continued growth in production from the US, Libya, Nigeria, and Kazakhstan have helped drive regional demand growth, offsetting market weakness by spreading the fleet over a wider geographic area.

Turning to slide five, we discussed the outlook for the remainder of 2017. As the chart on the left indicates, we are currently in the highest phase of the midsized tanker fleet growth, 54 vessels expected to deliver into the global fleet during the second quarter. We believe this will have a negative impact on freight rates in the short term. However, unlike the previous market downturn in 2013, changing trade dynamics evident in the first quarter are expected to continue through the remainder of this year, which we expect will partially offset the negative impact of this higher-than-average fleet growth. On the oil supply side, US crude exports have averaged 750,000 barrels per day thus far in 2017, up from 485,000 per day last year, and in February, reached a record high of 1.1 million barrels per day. These exports are increasingly moving to Asian and European buyers, which is supportive of mid-size tanker demand in the form of reverse lightering and cross-Atlantic trade into Europe. Teekay Tankers is well positioned to benefit from this export growth through the build-up of our Aframax presence in the US Gulf, and through the 2015 strategic acquisition of our ship-to-ship or SGS transfer business, where we have completed approximately 30 reverse export lighterings, year to date, on top of the normal volume of crude oil imports via STS lightering into the region.

Outside of the US, we are seeing an increase in supply from other Atlantic basin producers such as Brazil and Kazakhstan, both of which are positive for midsize tanker demand. Nigeria and Libya, both exempt from OPEC supply cuts, are also showing signs of recovery. In Nigeria, the re-opening of the Forcados Terminal, which typical loads around six Suezmaxes per month, and has been offline since February of 2016, is expected to provide some support to Suezmax demand in the region. Libyan production is also increasing and still to return to service, which will provide some support to midsized tanker rates in the Mediterranean, as we are seeing today in the Aframax trade. In sum, we believe that as Atlantic base in production continues to increase, while Middle East OPEC exports decline, the midsized tanker market will find support from pockets of volatility, as Asian buyers diversify their crude sources and interregional trade continues to grow.

Turning to slide six, we look at the positive fleet fundamentals, which we believe should help drive a tanker and market recovery from 2018 onwards. As shown by the chart on the left, three years of very low scrapping have led to a build-up of over 300 older midsized vessels, aged 15 years or older, which will likely face scrapping decisions in the coming years. When held up against the current order book of under 200 vessels, it appears that midsized tanker fleet growth should drop significantly starting in 2018, particularly as impending regulations such as ballast water and low sulphur regulations encourage more scrapping, as owners look to avoid costly capital expenditures in meeting these requirements on top of traditionally higher scheduled docking cost.

Although recent weeks have seen a series of new tanker orders being reported, most of these orders have been in the VLCC segment, with only two Suezmax and13 Aframax orders placed since the start of the year. Furthermore, we believe that ordering will remain limited to a small number of owners, and that financing constraints and shrinking yard capacity will help keep the overall level of orders low, compared to historical averages.

Turning to slide seven, I will wrap up with an update of spot tanker rates for the second quarter of 2017 to date. Based on approximately 55% and 52% of our revenue days book, spot revenue days book, Teekay tankers first quarter to date Suezmax and Aframax bookings have averaged approximately $19,215 per day respectively. For our LR2 segment with approximately 40% spot revenue days booked, first quarter to date bookings have averaged approximately $14,700 per day. Overall, we expect headwinds for tanker rates in 2017. However, we expect this near-term dip in the market cycle to be relatively short term in nature, as a lack of new tanker ordering in the midsized segments and increased scrapping due to regulatory changes, as well as a more balanced oil market, is anticipated to create the environment for market upturn in 2018.

With that, operator, we are now available to take questions.

Operator: Thank you sir. Again, if you would like to ask a question, you can do so by pressing star one on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again, that's star one if you would like to ask a question. We'll first go to Jon Chappell with Evercore.

Jon Chappell: Thank you, good morning Kevin.

Kevin Mackay: Good morning Jon.

Jon Chappell: The first question is on the sale and leaseback transaction, so you gave us the $153 million and said they're modern ships. Is there any way you can give a little bit more information on that transaction at this point, either which ships are involved, whether it's going to be a bareboat or time charter leaseback, and what the associated rates would be?

Vince Lok: Hi Jon, its Vince. I can't give a lot of details. We're just in the process of finalising those, but as mentioned, this is really a refinancing transaction which gives us additional liquidity of about $30 million. It also allows us to stretch out the repayment profile, given the 12-year tenure of the leaseback. It is a bareboat leaseback, so it is a financing transition and it includes some purchase options, some attractive purchase options, during the term of the leaseback. And they are related to four of our more modern Suezmaxes.

Jon Chappell: Okay, I'll take that, for now. The last time we spoke, Vince, you also gave me an update on the debt amortisation schedule on the fourth quarter conference call. What does the new quarterly amortisation schedule look like, post the completion of this deal?

Vince Lok: It will be on a run rate basis I would say a little bit under $100 million per year, so about $25 million a quarter on a run rate basis, so we have been able to produce that.

Jon Chappell: Okay, good. And then you kind of –

Vince Lok: And as you know, as you know we still have the older tank well, which has now eliminated that November 2017 maturity, so that one is now gone under the liquidity.

Jon Chappell: Right, yeah, that I was aware of. A couple of more things quickly. So $30 million of extra liquidity, and you have laid out a market outlook where choppy this year, pretty optimistic for next. Is this kind of the last step? Is this enough for what you think you need as far as getting the balance sheet in a position to withstand this market? Or should we expect to see other transactions similar to this as we kind of go through the weaker period of 2017?

Kevin Mackay: I think it's something that we are obviously keenly focused on, Jon, something the management monitors on an ongoing basis, and we speak to the Board about it every quarter or so. I think a lot of it will depend on where we see the summer freight rates going and how early we get into the winter upturn. And we'll continue to evaluate if there is more that needs to be done to support the balance sheet and make sure that we're positioned well as we come out of this short-term dip in the cycle.

Jon Chappell: Yeah, a final quick one, then I'll turn it over. I noticed that you had done about $13.5 million of the ATM in the first quarter. Can you also update us on how much of that remains, as far as the authorisation is concerned, and whether or not you plan on remaining active in that as well?

Vince Lok: Yeah, just to clarify, that $13 million that you have mentioned was completed in January which we have talked about on the last earnings call already, so we haven't issued anything new since our February earnings call. In terms of the remaining authorisation, I think there is roughly about $45 million left under that cop[?] or that sort of a long-term shelf that's in place. So as I mentioned, we haven't used any of that over the past quarter.

Jon Chappell: Okay, thank you Vince, thanks Kevin.

Kevin Mackay: Thanks Jon.

Operator: Okay, and next we'll go to Gregory Lewis with Credit Suisse.

Gregory Lewis: Yes, thank you and god morning.

Kevin Mackay: Morning.

Gregory Lewis: Kevin, just as we think about – I mean, clearly there has been a lot of headwinds this year facing the tanker market right? I mean, we have seen OPEC cut. You know, I guess what we're wondering is it looks like the Atlantic basin has done a fairly good job of replacing some of those lost barrels into the market. How is Teekay thinking about that, and the ability for when – OPEC is probably going to extend the cuts, but OPEC will eventually come back online with more volumes. How do you think about the push and pull of OPEC coming back on the market and the potential impact that has on some of these Atlantic volumes that we have been seeing?

Kevin Mackay: Well, I think clearly the Atlantic basin has taken away a lot of the brunt of the OPEC cuts, and has spread out a ton-mile to a beneficial effect for tankers and somewhat put [inaudible] rates could have gone with the fleet by coming online. So I think looking forward, as we have seen the US Gulf exports have ramped up, and I think we'll continue to see that. And I think we are well positioned with Teekay Tankers because of our strategic move in 2014/15 to build up our fleet and position it in the Atlantic, or more so in the Atlantic, focused on the US gulf and our STS[?] business. So I think we'll continue to get underlying support from US exports.

We have had a year of depressed Nigerian exports, which seem to be coming back online. And with the opening of the Forcados pipeline and the Shell terminal, we should see other six cargos a month on Suezmaxs for that. It will help to support rates. So I think while OPEC may be considering the extension of cuts through the remainder of this year and possibly into early 2018, I think the US Gulf, Nigeria, more production in Libya and Kazakhstan, will all bolster midsize cargo volumes, which should be supportive. And then as OPEC comes back – as oil markets rebalance and OPEC comes back, that can only be positive for all tanker segments, as this period of fleet growth tends to diminish towards – as we get into 2018 and certainly into 2019.

Gregory Lewis: Yeah, we were on the same page. And then just you mentioned the STS business and more volumes leaving the US on exports. You know, I mean, realising that we're seeing reversals of some of the work that the STS fleet has been doing, should we be thinking about opportunities to deploy additional vessels on that, in that market? How is that market? Is that market – if you were to characterise as a kind of – is it firm, is it sloppy? I mean, is there an opportunity for better economics or even more equipment in the STS market?

Kevin Mackay: I think it's something that we are following closely, because there is various dynamics that play in that region. As you know, Venezuela is going through some extreme political turmoil, which is having an impact on Venezuelan crude. At the same time, US exports continue to ramp up and the figures seem to get larger and more consistent on each month. So it's something that we have the capacity to move more tonnage into the area if volume grows, but it's not something that a lot of people can do. The STS operations require expertise, and that was why we purchased the franchise in 2015, so it's a fairly closed market for new players to get into. So as it grows, I think it will be a question of positioning more assets into the region, and bolstering up our band of experts that can perform those jobs.

Gregory Lewis: Okay, great, hey guys, thank you very much for the time.

Kevin Mackay: Thank you Greg.

Operator: Next, we'll go to Mike Webber with Well Fargo.

Donald Bogden: Good afternoon guys, this Donald Bogden stepping in for Mike, how are you?

Kevin Mackay: Good Donald, how are you?

Donald Bogden: Doing well. So the bulk of my questions have been answered, so I will just ask a quick one on sort of your allocation between the stock market and the time charter fleet following the out-churning of that Suezmax. I mean, are you generally happy with that mix moving forward or moving into the weaker southern[?] market? Would you like to increase that mixed[?] shift of time chartered [inaudible] to this bond market?

Kevin Mackay: Actually it's a good question. You know, I think, as an overall portfolio, we are comfortable to build up our fixed income exposure or fixed income cover to close[?] to 40% now as we go into these weaker period in the market. You know, if we can get additional shorter cover that can put a floor under our revenue stream through the weaker summer month, I think you may see us do some short term out chartering. But we are also having to balance that with our forward view. We don't want to lock in too much of the fleet for too long and miss the turn as we get into 2018 and beyond. So I don't think you will see us do any long-term TCs unless they are strategic in nature and are with a particular strategic customer. But I think it will be a balance between where we see short-term, midterm rates, and where we think we can lock in the revenue, so it's a space where we continue to watch.

Donald Bogden: Got you, thank you for that colour[?]. And then just one follow-up on shipyards. In your previous Q4 presentation, you had a slide on what you thought the decrease year on year and shipyard capacity spend. Do you have any update to that or any additional market colour on sort of the sate of shipyards right now, especially with the new administration in Korea indicating that they might stop financing and subletting[?] their shipyards?

Kevin Mackay: Yeah, I think, we have seen since I think 2011 to 2012, capacity has dropped off roughly about 30%, thereabouts. We're anticipating that will probably come off another 10% in the next year or a couple of years, so there is definitely a contraction of capacity. Some of the recent orders that you have seen, particularly in the VLCC segment, has filled some of the near-term capacity gaps for some of the shipyards were facing. So I think it bodes well in terms of available capacity being pushed out further into the backend of the decade, which should be helpful for the long-term outlook on the market.

Donald Bogden: Okay, that's it for me gentlemen, as always, thank you for the colour.

Kevin Mackay: Thanks Donald.

Operator: And now we'll go to Magnus Fyhr with Seaport Global.

Magnus Fyhr: Hey guys, just a follow-up question on the reverse [inaudible] in the Gulf. I guess there is some news out of Oxy that they are trying to pursue loading crew directly onto VLCCs. Have you heard anything of that, and how would that impact your ship-to-ship transfer business or the reverse layering[?] business?

Kevin Mackay: Yeah, it's a good question Magnus. The report that was out in the market about a VLCC going into Corpus Christi to the Oxy terminal, it's an experimental move to see what it would actually take to be able to accomplish something like that. At the moment, the draft restriction in Corpus Christi is quite severe for VLCCs, you can't load a VLCC more than half way. So, there is also restrictions in terms of the terminal berth being able to accept a VLCC alongside. And this is I think a trial to see what it would actually take investment-wise to make upgrades to docks and pipelines etc. in order for that to be accomplished. So, it's an interesting development, but I think in terms of the infrastructure restrictions and the amount of investment required to upgrade those ports to accommodate these, I think we're a long way off from having any impact on our STS business. So, we're watching it, but I'm not wholly concerned at this point in time, that that's going to materialise into anything.

Magnus Fyhr: Okay, and as far as Suezmax going into US ports, which ports can accommodate that currently?

Kevin Mackay: It can take us a while to go through the list. There's various – it's not just the ports, but specific terminals have different draft restriction. So if you want, we can provide you with that list offline, but at this point I don't think I can go through every –

Magnus Fyhr: Yeah, I didn't think it was that many, but I thought most of it was restricted to Aframaxs, but anyway, just a different question moving over. You mentioned a lot of the new activity has been on the VLCC side. I mean, does that concern you at all? I mean, you would think that would have some impact on the Suezmax market as well.

Kevin Mackay: No, I think there has been 20 of these reported to have been done. I think if you look at the players, they are well established, healthy – all companies with healthy balance sheets that can afford the financing of those deals. I think those types of buyers are limited, so we have to understand that last year was the lowest level of ordering since the mid 1990s, so we have to expect going into 2018 and 2019, that there is going to be ships ordered. The question is whether we go too heavily into ordering. But I think that at this point, we are only 30% into an average – or below the average of what normally gets ordered on an average basis. I think we're still within safe limits. And certainly on the mid-size space, we are well below historical averages, so at this point I'm not concerned.

Magnus Fyhr: All right, thanks for your time.

Kevin Mackay: Thanks Magnus.

Operator: Our next question comes from [inaudible] with Morgan Stanley.

Speaker: Yes, hi gentlemen. Most of my questions have been answered. I only want to ask you about the last few weeks, we have seen a decline in both VLCC and Suezmax rates. To what degree do you think that this decline, relatively to earlier this quarter, is attributed to the deliveries of additional vessels or the upcoming deliveries later this month, and to what degrees is it because of supply cuts from OPEC?

Kevin Mackay: Hi [inaudible], yeah, I think one of the impact that we have seen in recent weeks is the second quarter is actually the peak for deliveries in the Suezmax space. So we have seen an awful lot of vessels entering the market, and as they come out of the Far East and look to load in the AG, that's putting a downward pressure on rates and impacting market performance in that area. I think we are also seeing an onslaught of VLCCs in the first and second quarter. And they are impacting the market more and more as they get vetting approvals and start to assimilate into the fleet. So I think it's really an issue of second quarter fleet supply increasing substantially over previous quarters. But on the Suezmax space, I think this is the worst we're going to see, and as each quarter rolls by, the numbers get far less into 2018.

Speaker: From your answers, shall I take that supply continues uninterrupted? I'm just trying to find out how quickly do we expect – or do you expect the oil market to rebalance, and if OPEC countries, they comply to the supply cuts.

Vince Lok: Yeah, we do think that OPEC supply cuts will continue through the rest of 2017 and possibly into the start of 2018. I think the Saudis came out in the last couple of days and have said, along with Russia, that they might extend that for nine months through to around March time. If you look at the sort of global oil demand and non-OPEC estimates, if OPEC does maintain these supply cuts for the next nine months, it should reduce global oil inventories by about 300 million barrels, which gets you back pretty close to the five year average, which is where OPEC wants to get to. So again that's one of the reasons why come 2018 we think that the demand side, as well as the supply side, is going to look better because once the oil market is rebalanced as we get into Q1 and Q2 of 2018, I think there’s scope there then for OPEC to increase production, in addition to the volumes that are already coming from the Atlantic and gong to Asia as well. So we’ll be positive for tanker demand at a time when Kevin said fleet rate is coming up.

Speaker: Thank you very much.

Kevin Mackay: Thanks [inaudible].

Operator: And next we’ll go to Noah Parquette with JP Morgan.

Noah Parquette: Thanks, I wanted to dig a little bit into the US crude exports. You know, from what you have seen so far this year, what vessels that’s gone on? Has that mostly been on VLCC trade? And if so, how are those vessels trading, and what trade routes are those vessels coming from and integrating into the rest of the trading fleet?

Kevin Mackay: Yeah, hi Noah, it's been a mix. I think obviously the export, or the initial export of the crude has to go on Aframaxs because they are the only ones that can fit alongside the shallow draft berth. Some of those are being transhipped onto VLCCs, some have been moved onto Suezmaxs, but we have also seen a fair volume of Aframaxs delivering straight from the US Gulf into Europe. And recently we have seem one Aframax carry a cargo through the Panama Canal and try and ship onto the Suezmax of the Pacific coast of Panama, headed for Japan. So it's a mix of vessels being used but primarily Aframax as the primary mode. Like in 2016, the last figure I saw was 80% of the export volumes have been on Aframaxs.

Noah Parquette: Have you seen any effect where the rates in that area now are attracting ships to the region? Like, I guess would you expect to see some sort of increase in US crude imports as well, because the owners who want to get their ships to the region, would take discounts to go there?

Kevin Mackay: No, I think owners will always look to find the best rate they can for each of their voyages. You know, they may take a triangulated view and see if there is cargos that can position them into a region. But I think there's a steady volume of import of the heavier grades of crude into the US Gulf, and again those have to be loitered[?] off of larger vessels onto Aframaxs. Other than that, I wouldn't comment any further on that.

Noah Parquette: Okay, and then just to follow-up on the sale lease tech[?],are those going to be accounted for as capital leases or operating leases?

Vince Lok: Given the length of the leases of about 12 years will likely be capital leases. They will be on our balance sheet.

Noah Parquette: And I guess you have seen a lot of those across different vessel types. Notably these are on unchartered ships, is that correct? I mean, at what point do we say that this is – do you still believe that there is a lack of capital for ships right now, or is this just replacing this as one form for another, or how easy is it to attain this type of financing?

Vince Lok: I think you are seeing some other tech owners do similar financing transactions on the sale leaseback basis. And as you probably followed, there has been some contraction in the shipping banking markets, particularly in Europe and North America, just given some of the challenges in the other sectors and including offshore and dry bulk. So I think for ship owners, this is another alternative to finance ships. In this case we are taking some of our more modern ships and getting better repayment profile and additional liquidity and diversifying our sources of capital. So just it's just another one of the several levers that we have available to us.

Noah Parquette: All right, thanks.

Operator: And now we'll go to [inaudible] O'Donis[?] with UBS Securities.

Speaker: Hey good afternoon Kevin and Vince, thanks for squeezing me in here. Just one quick one for me on the dividend, I don't think it's come up yet. Obviously, hitting[?] that minimum amount here in the last few quarters, which I have seen make sense, just giving the market environment. But as you think about the recovery in 2018 that you expect, you have obviously given yourselves a lot of discretion around where the payout is going to be. So just curious how you think about that here when you get that recovery, is there an appetite to maybe keep that dividend lower and then recycle some of that cash or growth? Or do you think you sort of bring it back up to that 30% to 50% level as soon as you can? Thanks.

Vince Lok: Yes, as you know, our divined policy is to pay out 30-50% of adjusted net income per share, with a minimum quarterly dividend of $0.03 which is what we declared in the past couple of quarters at least. It is something that we of course discuss with our Board on a quarterly basis. Right now we don't have any intentions to change that. And of course if earnings were to pick up as we expect in 2018, that minimum dividend would go above the $0.03 and be based on the 30-50%. We don't have any plans on changing that range right now. The 30-50% we think is a prudent percentage to give a balance of return of capital to shareholders over the long-term, as well as retaining enough cash flow for reinvestment in the business. So right now there is no particular change. The dividend is a relatively small amount, it's about $4.5 million a quarter, so it's not a huge dent on the overall balance sheet.

Speaker: Yeah, okay and that's very clear, appreciate the colour, thanks Vince.

Operator: At this time we have no further questions, so I would like to turn it back over to Mr Mackay for any additional or closing remarks.

Kevin Mackay: Okay, thank you everybody and we'll speak to you next quarter.

Operator: And that does conclude today's call. We thank everyone again for their participation.