Company: TEEKAY TANKERS LTD.

Conference Title: Teekay Tankers Ltd.'s Second Quarter 2017 Earnings Results Conference Call

Conference ID: 7266182

Moderator: Emily Yee

Date: August 3, 2017

Operator: Welcome to Teekay Tankers Limited's Second 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 1 to register for a question. For assistance during the call please press star 0 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 Mr. Kevin Mackay, Teekay Tankers Ltd's, Chief Executive Officer. Please go ahead, sir.

Ryan Hamilton: Before Kevin begins, I would like to direct all participants to our website at teekaytankers.com, where you'll find a copy of the second 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 statements is contained in the second quarter 2017 earnings release and earnings presentation available on our website.

I'll 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' second 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 an adjusted net loss of $7.1 million or 4 cents per share in the second quarter of 2017 compared to an adjusted net income of $7 million or 4 cents per share in the first quarter of this year. We generated free cash flow of $18.7 million during the quarter compared to $34.4 million in the previous quarter.

Our results were negatively impacted by lower spot tanker rates in the second quarter, which I will elaborate on later in the presentation. In accordance with our dividend policy, Teekay Tankers declared dividend of 3 cents per share for the second quarter of 2017, representing the minimum quarterly dividend.

As discussed in our news release in late May, Teekay Tankers agreed to acquire Tankers Investments Limited or TIL and its of fleet of 18 mid-sized conventional tankers in a share-for-share merger. I will touch on the benefits of this transaction later on in the presentation.

In July, we completed the previously announced 12-year sale leaseback financing transaction on four modern Suezmax tankers, increasing our liquidity position by approximately $30 million. The transaction is structured as a 12-year bareboat charter at an average rate of approximately $11,000 per day with attractive purchase options for all four vessels throughout lease term commencing after year three. This transaction further strengthens our financial position by increasing liquidity, while allowing us to maintain our scale.

Lastly, in May, Teekay Tankers secured a time charter out contract for 1 Aframax tanker at a rate of approximately $16,000 per day for a firm period of 18 months. The vessel delivered in late May and provides additional fixed rate cover as we continue through the weak tanker market.

Turning to slide four, I'd like to take a moment to underscore why we are excited about the value created by our proposed merger with Tanker Investments Limited. First, this transaction is consistent with our strategy of increasing shareholder value by investing and operating throughout the tanker cycle. The combined fleet of 62 vessels establishes TNK's market-leading presence in key markets in the US Gulf and the Far East, which will result in increased fleet utilization, the triangulation opportunities and improved earnings to the Company.

With an average age of approximately seven years, the addition of TIL's fleet will reduce Teekay Tankers' average fleet age from 10 years to nine years, giving us additional optionality for optimizing our fleet over time. As market conditions recover, the Company will have the option and sufficient scale to sell older assets, providing capital to reduce debt or pursue other opportunities.

As TNK has been responsible for the commercial and technical management of TIL's fleet, the Company expects a seamless integration of these two quality homogenous fleets. A further benefit of acquiring TIL vessels is that they will maintain all oil major approvals in the transition thereby avoiding the inefficient and costly process of having vessels reinvented.

Moving on to slide five, we'll discuss the compelling financial benefits of the merger. The Company expects the merger to be immediately accretive to earnings per share, which was 10% accretive based on 2016 pro forma results. The exchange ratio is 3.3 Teekay Tankers' class A common shares for each TIL common share represents a modest 3% premium on the fair market value of TIL's fleet during the period of historically low asset prices in our sector.

The merger is expected to reduce our financial leverage and increase total pro forma liquidity by approximately $100 million, which our Board determined is a superior approach to strengthening liquidity relative to other alternatives, which may have required the issuance of new dilutive equity. The combination is also expected to decrease all-in cash breakeven by approximately $,1000 per day, which is especially beneficial during a time of cyclical weakness in tanker rates. Lastly, we expect to generate annual cost savings of approximately $3 million.

Overall, the merger will substantially strengthen our financial position, and we expect this transaction to create significant shareholder value. Based on the current timeline, we anticipate completing the merger in October after obtaining shareholder approvals.

Turning to slide six, we look at developments in the crude tanker spot market as we enter a low point in the current tanker market cycle. In Q2, crude tanker rates were the lowest for second quarter since 2013, primarily due to an oversupply of tonnage. The tanker fleet has grown by 3.5% since the start of the year and 6.5% higher year-on-year. This high fleet growth is a result of orders placed in 2014 and 2015, which we're delivering into the market now, as well as several years of low volumes of tanker scrapping.

Tanker demand has grown through the first half of the year. However, the pace of growth would have been much lower than the previous two to three years. Rising supply from Atlantic producers, such as the United States, Libya and Nigeria, has benefited tanker demand, but this has been offset by cuts from the

Middle East OPEC nations. Rates have continued to decline in early part of the third quarter, which is normal for this time of year as refiners reduced their purchasing ahead of planned maintenance.

Turning to slide seven, we take a look at some of the green shoots, which we believe will pave the way for tanker market recovery in second half of 2018 onwards. Starting with the supply side, it is encouraging to see that tanker scrapping is starting to pick-up after two to three years of very low activity. July saw 1.3 million deadweight of tankers scrapped, which is the highest monthly total since November of 2013.

The combination of low freight rates, falling asset prices of older vessels and an aging fleet, are the main catalysts for this higher scraping. We expect scrapping totals to accelerate in the coming months as owners weigh up the cost to putting vessels through their 17.5 year intermediate and fourth special surveys against the cyclically low tanker spot market.

As shown by the chart on the bottom left of the slide, an increase in tanker scrapping and a reduction in new vessel delivery is expected to result in much lower fleet growth during 2018 and 2019. Per the current order book, we expect the tanker fleet growth to fall from around 5.6% in 2017 to just over 3% in 2018, and just over 1% in 2019. It is of course possible that more orders could be placed for 2019 delivery.

However, we are encouraged that tanker ordering have slowed down in recent weeks, and we believe that ordering will remain limited in the short term with continued shrinking shipyard capacity and limited available capital for owners to tap.

Turning to demand side, one of the main drags on growth this year has been OPEC supply cuts. Compliance with these cuts, however, is starting to slip with members only managing to achieve a compliance rate of 78% in June. Libya and Nigeria, who are exempt from the cuts, continue to increase their production levels and we're also seeing cracks appear in OPEC unity. Ecuador has stated that it can no longer comply with its agreed cuts, while Iraq has expressed its desire to push production up another 0.5 million barrels a day by the end of the year.

This extra supply from OPEC is positive for tanker demand, and with the agreement to cut output expected to expire in March of 2018, we anticipate that next year we'll see more OPEC volumes and therefore more cargos for transportation. We're also encouraged that Atlantic Basin oil production continues to grow. US oil production continues to rise, but exports have exceeded 1 million barrels a day at times during this year. This oil continues to move further afield, with China and India starting to take in more volumes.

Exports increased from Brazil as well as Libya and Nigeria, as I mentioned earlier, are also being seen. With IEA predicting a further 1.4 million barrels per day increase in non-OPEC supply during 2018, we expect the long haul movements from Atlantic crude will continue to rise. In sum, although the tanker market is currently at a cyclical low point, we can already see some of the green shoots of recovery and we believe that the tanker market will regain its positive direction in the second half of 2018 onwards.

Turning to slide eight, I'll provide an update on spot tanker rates for the third quarter of 2017 to-date. Based on approximately 47% and 42% of spot revenues days booked, Teekay Tankers' third quarter to-date Suezmax and Aframax bookings have averaged approximately 12,500 and 12,300 per day, respectively. For our LR2 segment, we have approximately 28% of our spot revenue days booked. Third quarter’s day bookings have averaged approximately $9,300 per day.

Turning to slide nine, I will touch on TNK's near term priorities. Our near term priorities, post-merger, will be consistent as we continue to focus on strengthening our financial position by further reducing financial leverage and increasing liquidity. We will utilize our various commercial levers to strategically position our fleet for the market recovery through active management of our time charter portfolio.

We'll continue to look for opportunities to modernize our fleet through sales of our older tonnage, and build upon our ship-to-ship transfer and commercial management businesses to increase our non-cyclical revenues.

In closing, Teekay Tankers is excited to have reached an agreement with Tanker Investments on an accretive merger, which will benefit both TNK and TIL shareholders. We believe this merger will significantly strengthen the company's financial position, while also providing sufficient scale and market presence to take advantage of the anticipated market up-turn in 2018.

With that, Operator, we are now ready to take questions.

Operator: Thank you so much. We'll start with the first question from the line of Gregory Lewis of Credit Suisse. Please go ahead.

Gregory Lewis: Hi, thank you. And good afternoon or good morning.

Kevin Mackay: Good morning, Gregory.

Gregory Lewis: Good morning. Could you talk a little bit about the ship-to-ship transfer business? I mean clearly in the prepared remarks you talk about leveraging that business. Yet, as I look at it sequentially, it looks like you let a couple of vessels roll off and looks like that fleet is shrinking a little?

Kevin Mackay: Well we have – based on the volume growth that we developed at the backend of the last year and into the early half of this year, we have approximately five ships that we've dedicated to that business. And then we supplement with vessels that we bring in from our pooling business, as well as some spot market. On a ratable basis, there’s roughly five ships dedicated to that.

In recent months, we have sold one of those five ships that we are looking to replace it by taking one of the Teekay ships from our pooling agreement and putting it back into that program. So going forward, while I think volumes will vary month-on-month, I think you'll probably see us through the rest of 2017 with an average of four to five ships in that trade in any given time.

Gregory Lewis: And there is really no expense for moving a ship into the STS, and is all the necessary equipment?

Kevin Mackay: Yes.

Gregory Lewis: Okay great. And then just one – okay great. And then just one big picture from me. You know, clearly, the OPEC cuts have been painful for the tanker market. But I guess on the flip side of that, we have been seeing increasing crude oil from the Atlantic basin. And I guess what I'm curious about is I'm curious on your thoughts about, as OPEC comes back online, whether that's in the middle of '18, late '18 or when OPEC eventually does come back online. How should we be thinking about that potentially impacting the Atlantic crude volumes that we've been seeing?

Kevin Mackay: Well I think, you know, we have to recognize the Middle East OPEC cuts have had an impact, primarily on the VLCC market. And that's why I think you're seeing -- although production in West Africa has been increasing significantly over this year, we haven't seen the added impact on rates that we're hoping for. And that is a result of the cuts from the Middle East driving VLCC tonnage more towards West Africa.

So I think as you see a reversal of that and OPEC starts to produce in higher volumes, we'll return more to a traditional sense where a larger volume of the Middle East crude will be carried by the V fleet, leaving a lot more opportunity and a lot more of in-balance of tonnage, both on the Vs and Suezmaxes in the Atlantic. So we should see a bolstering and a real driving home of the impact of the ton mile that the sort of West Africa and Caribbean voyages into China and India sort of drive. So I think, obviously, the return of Middle East crude is only positive for tankers.

Gregory Lewis: Okay, hey, perfect. Thank you very much.

Kevin Mackay: Thank you.

Operator: We'll take the next question from the line of Noah Parquette of JP Morgan. Please go ahead.

Noah Parquette: Thanks. Yes, I just wanted to ask about the sale leasebacks. You know, it seemed like a pretty good way to get a little more liquidity. You know, are there other ships that you consider doing that with? You know, I think, you know, just give me a sense of what other liquidity options you're looking at outside of the merger happening? Thanks.

Kevin Mackay: Yes, I think that's one of the positives of the actual merger itself, and one of the compelling reasons why the Board was so positive on it is by adding the additional vessels to the fleet with a younger fleet profile, it does give us a lot more options if the tanker marker were to incur, you know, longer headwinds than we anticipate. So I think with our current fleet, there would be limited opportunities with our fleet to do some additional leasebacks.

You would probably see us look to sell assets of the older vintage trying to raise liquidity. But, the TIL merger, is really something that gives us that option to look at sale leaseback, selling older ships at various other avenues. So that's why we're positive about it, and we think it's a compelling merger for the organization and for bringing value to the shareholders.

Noah Parquette: If you could just remind me -- do you have any ships in your fleet that are unencumbered and any ships in TIL?

Vince Lok: No, not currently. They're all pledged as security under existing facilities.

Noah Parquette: Okay. That's all I have. Thanks.

Operator: There are no further questions on the phone lines. I'll turn it back to you Mr. Mackay for closing remarks.

Kevin Mackay: Thank you very much. And we'll speak to you next quarter.

Operator: Ladies and gentlemen, this concludes today's conference. We thank you for your participation. You may now disconnect your line and have a great day.