TEEKAY GROUP THIRD QUARTER 2024 EARNINGS RESULTS CONFERENCE CALL

Company: Teekay Group

Date: Thursday, 31st October 2024

Conference Time: 11:00 ET

Operator: Please stand by. Welcome to the Teekay Group Third Quarter 2024 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 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 will find a copy of the Teekay Group's third quarter 2024 earnings presentation. Kenneth 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 Teekay Corporation and Teekay Tankers third quarter 2024 earnings releases and the Teekay Group's earnings presentation available on our website. I will now turn the call over to Kenneth Hvid, Teekay Corporation and Teekay Tankers' president and CEO to begin.

Kenneth Hvid: Thank you, Ed. Hello everyone, and thank you very much for joining us today for the Teekay Group's third quarter 2024 earnings conference call. With the recent management changes, this earnings call will cover both Teekay Corporation and Teekay Tankers earnings for the quarter. Joining me on the call today for the Q&A session is Brody Speers, Teekay Corporations and Teekay Tankers, ' CFO. Ryan Hamilton, our VP, Finance and Corporate development, and Christian Waldegrave, our Director of Research.

Starting on slide three of the presentation. Over the past few years, the Teekay Group has taken several important steps to streamline the organization. Notably, this includes the recent simplification of our group management and decision making structure. And TNK's planned acquisition of our Teekay Australia business, which we will cover in more detail later in the presentation, as well as Teekay Corporation's transfer of all of its remaining management service companies to TNK, which consists mainly of our shore based staff.

The results of these steps is a new structure that looks similar to historical Teekay, where Teekay Tankers is positioned as the fully integrated sole operating platform for the Teekay Group and Teekay Corp, has a strong supportive sponsor. Throughout the streamlining process, we have focused the group on tankers while systematically reducing a significant debt load. I'm very proud to say that following a multi-year effort, the Teekay Group today has one of the strongest balance sheets in the industry, with no debt and considerable cash positions, which we believe is important in a cyclical industry as a strong balance sheet allows us to act counter-cyclically at the right times in the cycle. TNK will remain committed to disciplined fleet and reinvestment, while Teekay will focus on managing its controlling interest in TNK and can provide financial support if necessary.

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On slide four, we will cover the recent developments at the Teekay Corp level. As mentioned, Teekay has agreed to sell Teekay Australia and also transfer its remaining management services companies to TNK to streamline and simplify the group. TNK will acquire Teekay Australia for $65 million in cash and transfer the management services companies for their net working capital value.

When we closed the sale of Teekay LNG back in early 2022. The group had approximately $300 million in capital available at the Teekay level, with TNK still waiting for the tanker market to turn and burdened with a significant debt position relative to the fleet profile.

Fast forward to today, While TNK has a fleet that will require some renewal, it has one of the strongest balance sheets in the industry, and therefore we do not feel the need to hold as much cash at the Teekay Corp level as we have over the past two and a half years. As a result, the company is allocating up to $230 million of its cash back into the business and in part as a return of capital to shareholders. This includes returning $144 million of capital to its shareholders since early August, or over 20% of its current market cap. Consisting of $59 million of share buybacks, at an average price of $8.56 per share, and a $1 per share special cash dividend to Teekay Corp shareholders, for a total dividend of approximately $85 million, payable in December. In addition, our board of directors has also authorized a new $40 million share buyback plan.

Lastly, Teekay also purchased $50 million of TNK class A common shares at an average price of just under $59 per share, increasing our economic and voting interest in TNK to 31% and 55%, respectively. We believe that TNK is well-positioned to continue to generate significant free cash flow and build equity value. This increases the underlying value of both TNK and Teekay Corp through its controlling ownership of TNK, and therefore we believe both the TNK share purchases and the Teekay Corp share buybacks represent good value. As a result, of all our simplification efforts and flexible capital allocation, we plan to continue to deliver shareholder value and hope to illuminate the underlying value in both companies.

Moving to slide five. We will cover the highlights at the Teekay Tankers level. TNK's third quarter earnings and free cash flow remained strong, with spot rates in the low to mid $30,000 per day. Adjusted net income was $63.5 million, or $1.84 per share, and our adjusted EBITDA was nearly $76 million. It is important to note that we strategically planned the drydocking of ten of our vessels during what is typically the weakest quarter of the year to ensure that our fleet was fully available for the anticipated winter tanker market uplift.

On TNK's acquisition of Teekay Australia, TNK is acquiring a business with an estimated annual EBITDA of $10 million, consisting primarily of stable, longer-term government service contracts at an attractive valuation. We like the stability of this government business and believe in its future prospects. I will cover this business in more detail on the next slide. With all the group's operations under TNK, it was a logical step to transfer all the remaining management services companies not otherwise owned, which is mainly our shore based staff to TNK.

Looking to what we have booked so far for the fourth quarter, it is closely in line with where we stood at this point last year. As you can see from the bar chart on the lower right on the slide. Importantly, as you can see from the red dots above these bars, the latest Clarksons reported spot rates in the market today have moved higher as we transition into the typically stronger winter season. We'll cover the tanker market in more detail later in the presentation. Lastly, Teekay Tankers has once again declared its quarterly fixed dividend of $0.25 per share, payable in November.

Moving to slide six, I will briefly cover the Teekay Australia business that Teekay has been operating for nearly 30 years. This is an asset light and CapEx light services business that carries out comprehensive vessel management, procurement and staffing, primarily for the Australian government on 11 vessels with total revenues in excess of $100 million and an average annual EBITDA of approximately $10 million. Teekay Australia's value add is its approach to the business with a ship owners mindset. We are one of the largest employers of Australian seafarers and have strong government and industry relations that have been established over nearly 30 years.

Leveraging Teekay's industry expertise, Teekay Australia has secured stable long-term contracts in a niche market. While this accretive investment for TNK is small relative to our core tanker business, we like the asset light model, first class customer base and stability of cash flows. We also believe that growth opportunities in this business over time, and we are in a great position to pursue these opportunities as they arise.

Turning to slide seven, we look at the near-term outlook for the tanker market. Spot tanker rates remain historically firm in Q3 and were amongst the highest for a third quarter in TNK's history. As is typical for third quarter, rates showed a seasonal downturn compared to second quarter due to a combination of lower crude oil export volumes from various major oil producers. The onset of seasonal refinery maintenance and relatively weak Chinese crude oil imports.

However, as can be seen by the chart on the bottom right, spot rates are firming at the start of Q4 in line with normal seasonality, with the shape of the curve so far looking very similar to 2023. We expect spot tanker rates to remain relatively firm through the winter, though it's too early to say whether they will match the strong rates seen in Q4 of last year. We believe tanker rates will be supported by seasonally stronger oil demand and, more importantly, an increase in crude oil export volumes from key producers.

The reduction in Libyan crude oil exports seen in September due to a dispute between the two regional governments, also appears to be in the process of normalizing, which is adding support to tanker demand in the Mediterranean.

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. Finally, the potential for higher OPEC+ supply should they decide to proceed with the unwinding of 2.2 million barrels per day of voluntary supply cuts and a possible boost to Chinese crude oil imports due to recent government stimulus could also support rates during Q4.

Turning to slide eight, we look at tanker demand and supply factors, which we believe point towards continued tanker market strength over the medium term. Global oil consumption, which is already at an all-time high, is expected to grow further with projected growth of 1.3 million barrels per day in 2025, as per the average of forecasts from three major energy agencies. The majority of this growth is expected to come from Asia, particularly from India, which is the second largest importer of oil in the world after China. But importantly, it is expected to be the global leader of oil demand growth going forward.

Global oil supply is also at an all-time high and is set to grow further due to increasing production in non-OPEC+ countries. As per the IEA, non-OPEC+ supply is projected to grow by 1.5 million barrels per day in 2025, led by Atlantic basin producers such as the United States, Brazil and Guyana. Given that the bulk of oil supply growth is in the Atlantic, but demand growth is concentrated in Asia, we expect that the long-haul movement of crude oil from west to east will be a key driver of tanker ton mile demand in the medium term.

We should also mention that in addition to positive underlying oil market fundamentals, the tanker market continues to be shaped by geopolitical events. This is particularly evident in the Middle East, where ongoing attacks on shipping in the Red Sea region are causing tankers, particularly in product tanker sector, to divert around the Cape of Good Hope, thereby adding to voyage distances and boosting tanker ton mile demand. Recent events in the Middle East have the potential to further destabilize the region, which could impact oil production and shipping should they escalate further. The full effects of any such disruption are uncertain, but they have the potential to further add to tanker market volatility in the coming quarters.

Turning to fleet supply. New tanker deliveries are set to increase in 2025 and 2026, due to orders placed over the past 18 to 24 months. However, at around 13% of the existing fleet, the global order book is still below the long term average of 20%. Furthermore, forward order book cover at the major shipyards currently stretches three years or more, with a lack of available shipyard capacity until the second half of 2027. In addition, the fleet continues to age, with the average age of the tanker fleet currently the highest since 2002.

As can be seen by the chart on the bottom right, the number of vessels on order is still relatively small compared to future fleet replacement demand. The combination of a modest order book, a lack of shipyard capacity, and an aging fleet should ensure that the tanker fleet growth remains at relatively low levels over the next two to three years. While the pace of tanker scrapping remains very low, the past two years have seen a steady flow of vessels from the conventional fleet to the so-called shadow fleet of tankers servicing sanctioned trades. The majority of which are older vessels which would otherwise be approaching end of life.

This shadow fleet now counts several hundred vessels, which generally operate at much lower utilization levels compared to the conventional fleet. While the future of this shadow fleet is uncertain, particularly in light of increased scrutiny and sanctions from both the US and Europe, the migration of ships from the conventional fleet to the shadow fleet adds an extra layer to tanker market volatility.

In sum, we believe that tanker demand and supply fundamentals continue to look positive, which should lead to ongoing strength in the tanker market over the medium term.

Turning to slide nine, we highlight how the Teekay Tankers fleet profile is ideally situated to maximize value in the current market. As mentioned at the beginning of this call, we have spent considerable effort and resources over the several years to eliminate our outstanding debt. This, in turn, has enabled us to bring our free cash flow break even down dramatically to approximately $14,000 per day, which I want to highlight is a really extraordinary level for mid-sized tankers and amongst the lowest in our peer group.

With the fleet's low break even, high utilization for mid-sized tankers and the near-total exposure to the spot market, we're able to generate significant free cash flows, which over the last 12 months has totaled approximately $13.29 per share. Moreover, for every $5,000 increase in spot rates above our breakeven level, our annual free cash flow yield increases 4.8% or generates approximately $2.30 in free cash flow per share.

In summary, the Teekay Group is streamlined and fully oriented around the Teekay Tankers operating platform, with Teekay Corp focusing on managing its controlling interest in Teekay Tankers. We are optimistic about the market dynamics ahead of us, and as we continue to generate earnings and maintain our discipline and long-term orientation in deploying or retaining that capital, we look forward to continuing to build shareholder value at both TNK and Teekay Corporation. With that operator, we are now available to take questions.

Operator: Well, thank you. If you would like to signal with questions, please press star one on your touch tone telephone. If you're joining us today using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, that is star one. If you would like to signal with questions, star one. And our first question will come from Jon Chappell with Evercore.

Jon Chappell: Thank you. Good morning. Welcome to the hot seat, Kenneth. So just multi-part first question as we try to understand the structure going forward. First of all, is there anything else within the Teekay Corp structure that would need to be consolidated to TNK? And then secondarily, what's the plan going forward? They have the 31% ownership, there's also the class B shares. Is there any plan to either simplify the structure into one class of shares or I guess become even closer through somewhat of a consolidation type model.

Kenneth Hvid: Good morning, Jon. Good to be talking to you again. It's been a while but happy to be back here. And so the plan going forward here is that the structure that we have right now is really that we intend to – first of all, I want to say the business and the strategy remains the same, but we just have a simplified structure. As you can tell, the accent is a little bit different from Kevin here. But what we've been really working towards there over the past couple of years is really just aligning Teekay Corp and TNK with the main investment being Teekay Tankers.

And with the improvement of the balance sheet, we basically saw that we could now take the last final step and align both the management structure to the drop down of Teekay Australia and the management companies. So to your first question, that really completes that simplification. And there is nothing left at Teekay Corp level to be dropped down. To your second question, in terms of further aligning the structure, as you know, we have a shareholder legacy structure at Teekay, which is important. And that's been particularly important over the past five years for the company.

What we are doing hopefully with this transaction is that we are illuminating the value that we have in Teekay Corp. We think from management side, it's important to have a strong supportive shareholder. And from when we established TNK, it was always a controlled company of Teekay Corp as you know. So we're very happy with that structure. And it's worked really well for us also in the last couple of years where the stock has performed extremely well.

Jon Chappell: Okay. Great. Just a quick follow up on the modeling of the Australian business. So I get the 100 million of revenue and the 10 million of EBITDA. First of all, when does that close? Is that a fourth quarter event or does it start on January 1 of next year? And second of all, if you can just break down a little bit of that cost structure, how much of it is G&A, how much of it is core OpEx? Just to get the model set up.

Brody Speers: Hey, Jon. It's Brody here. So in the first part, we're aiming to close the transaction by the end of this year, so by December 31st. In terms of the numbers and the breakdown, it's showing up right now just as revenue and OpEx. And so that's probably how you're going to see it going forward at Teekay Tankers is roughly $100 million of revenue and roughly $90 million of OpEx.

Jon Chappell: Okay. Easy. Thanks, Brody. Thanks, Kenneth.

Kenneth Hvid: Thank you.

Operator: And the next question will come from Omar Nokta with Jefferies.

Omar Nokta: Thank you. Hey, guys. Good morning. Just maybe wanted to ask a couple of questions, but maybe just a quick follow up to Jon's last one on the Australia business. Is any of that 10 million of EBITDA, is there a tax that it's subject to?

Brody Speers: Yeah. The business is subject to tax in Australia at 30%. And there's some deductions that we can take on that, but it is a taxable business. Yeah.

Omar Nokta: Okay. All right. Thank you. Okay, good. So just want to maybe ask a couple of questions from, say, the TNK perspective. obviously continuing to build cash. And you found a couple of low hanging fruit items within the Teekay system to deploy some of that capital. I wanted to ask, just in terms of other low hanging fruit you mentioned, that's it in terms of dropdowns. But I guess where you are today, you've streamlined the structure, you've eliminated all the debt at TNK, what would you say is your main strategic priority now for TNK?

Kenneth Hvid: With TNK, it's continue to deliver value and build value. We've said all along here that the profile that we've had through this tanker cycle with the fleet, and Kevin has commented on that in the past. We really like, because that's giving us maximum operating exposure to this market. With a low break even, we obviously generating a lot of free cash flow. In a cyclical business, it's always the discussion around, when do you start renewing your fleet and when do you keep your exposure to the spot market, and when do you start taking some off and put some on time charter.

And similar to in the past, we're looking at all of that all the time. We're looking at potentially selling some of our older ships. We're looking at potentially buying a few younger ships, and we're looking at potentially chartering out some of our ships. So it remains very dynamic. But as you well know, we've kept and been very focused on keeping the fleet with as much spot exposure as we could. And that has been absolutely the right call, as we are now two and a half years into the cycle.

We're still looking at it. As we said in my prepared remarks, we still like the fundamentals. We have a couple of rounds to go here. Still, the winter has not even begun yet. And so we're happy with the spot exposure we have right now. And the focus is really just trying to maximize as much as we can on this market that we're in.

Omar Nokta: Thanks, Kenneth. Yeah. No, I appreciate that. So it seems like more of the same, the consistent strategy being methodical, and no real major change in the approach post this simplification.

Kenneth Hvid: That's absolutely correct. We've been very aligned on that from day one, but obviously we had some legacy things. And then now, we're really back to, as I said also in my remarks, if you think some years back we had Teekay, which was the fully integrated company, and that's really what Teekay Tankers has become. So that's a very exciting point to finally have reached that again. And that sets us up well and gives us a lot of flexibility for where we can go in the next years.

Omar Nokta: Yeah. No. Absolutely. And then maybe just one final one just for me on the market. And you talked about the setup, but I did want to ask, as we think about how things are set up at this point, you could say perhaps that you've got a relatively stable, say, global Aframax fleet versus, say, last year or over the past 12 months.

But you've now introduced this new trade pattern out of Vancouver via the TMX expansion. Clearly in the tanker market today and looking at stock prices and overall sentiment, there's a sense that rates are unexciting. But winter is on approach. Typically things get tighter, as you were highlighting in your remarks. How do you think this winter plays out with TMX here at or near full capacity? Do you think the market is prepared for this? Are charters prepared? How do you think about that as we get closer to winter?

Kenneth Hvid: Yeah. I would say the winter is absolutely not over. It's not even begun. That's the key point. It feels a little bit like the market has called the winter over before it started. But there is absolutely a pulse in the market. We are not quite seeing the take-off that we saw at this time last year, as I also said. But when you look at the curve, we're pretty close, sitting at the same level that we actually were at this at this time last year.

We have a few new dynamics this year. TMX is up and running and it continues to increase the loadings this month as well the last month in October. They were up to 24 loadings. The capacity is just over 30 loadings a month. We see more of the voyages going to Asia. Nine of the of the cargoes went to Asia direct, and four of them went down and did an STS. So that's all helpful obviously to the volume. And that's the thing on the medium sized tanker fleet. We continue to see how those flows, they ebb and flow. And it's about being able and being global and being positioned to benefit from them. So we see variability, but there's absolutely a pulse in the market I can tell you.

Omar Nokta: Very good. Great. Thanks, Kenneth. Thanks, Brody. I'll turn it over.

Kenneth Hvid: Thanks.

Operator: And the next question will come from Ken Hoexter with Bank of America.

Ken Hoexter: Hey. Good morning. So I just want to revisit the question earlier, if you're buying all of the stuff in and you said now TNK looks more like what Teekay did, can you clarify why you still have the dual listing? And will we see further consolidation into that?

Kenneth Hvid: Yeah. Teekay has been listed since 1995. So it's a legacy ownership structure that we have when we started the daughter companies, we've been evolving it. What we are highlighting here, I know it's a little bit of an unusual structure where we have two listed companies essentially invested in the same underlying business. But we've done a pretty good job now, hopefully in illuminating the underlying value in TNK. And we see that should really be flowing through to Teekay going forward.

The cost of combining the two, maybe it's something we'll consider at some point, but for now, it gives us added flexibility that we have two strong balance sheets. And in this market, having one strong balance sheet is always a great thing. But having two is arguably even better. So as I said in my earlier remarks as well, as you all know, we have a legacy ownership structure. TNK has always been a controlled company by Teekay and we like that structure and it's been beneficial for us over the years.

Ken Hoexter: I get it, Kenneth, but it brings or harkens back to the days of also a lot of concern about the daughter companies being the controlled entity and having no ability. Look at the stocks, ones up 13%. The one that is sending stuff down to the daughter and the daughter being, at least down at the open here this morning. I guess it just confuses a little bit why there's still the need for the two if it's all operating in one entity. But we'll figure it out over time. Does this represent the end of Teekay focusing then on other sectors or making investments in others? Obviously, you started off with that balance sheet to be able to invest in LNG, FSRU, shuttle tankers. Will it now be only crude tankers and still be at TNK?

Kenneth Hvid: Yeah. You probably asked Kevin that question in the past as well. What's important about the company that we have is that the model we have at Teekay is that we are an integrated shipping company. And what that means to us at least, is that we have in-house technical management, we have in-house commercial management, we have a global presence, and we think that's a value add and a differentiator in the market that we're in today. Of course, that's also a capability that gives us the ability to grow into other sectors.

So should we go to adjacent sectors and for example, decide to run, as Kevin has said, any other conventional shipping assets like product tankers or MRs or VLCCs, we could do so. That's not the focus at the moment. But what's important is that we have the capacity and capability to do so. And that's actually how we looked at the world also in the past, we've always grown out from our internal capability to move into other sectors. So I would say, Teekay Corp has looked at a number of different sectors over the past two years, and there's been a very dynamic shipping market in different segments.

But I've got to say that the market that we've liked the best and we've obviously been heavily invested in it, but it's performed extremely well, has been crude oil tankers. And when we look around at the different sectors today, we still like that profile. We like the profile we have in TNK, where we're able to generate a lot of cash flow, and that's quite frankly. Well, we don't like where the share prices are, but the valuation that we have in them, we think represent good value. And that's why we've been buying back stock at Teekay and we've been buying more TNK stocks. So for us it's all about creating value over the long term using our in-house skills to service our customers, and that's really what guides us.

Ken Hoexter: What was viewed as the advantage for TNK in selling the Australian asset down to TNK and was an independent review – I presume was right of independent directors done on the valuation?

Kenneth Hvid: Yeah. The timing of it was really so we could make the final step of this streamlining. So we have a consolidated management in one of the companies. You can argue that Teekay is becoming a bit more of the holding company. It was very important for us to find a valuation that was exactly middle of the road. And that's actually what we've done. There was a review done by, of course, the TNK board, but also its independent directors separately on the fairness of this. And we had external valuation done of the company as well. And it was very important for us to find exactly the middle of the road of this valuation. That's exactly what we've done here.

Ken Hoexter: All right. Wonderful. Excuse me. Sorry. On the business, Kenneth, you mentioned the move to balance spot or future. The potential to look at some more time charter outs and balance when the right time in the market is away from spot. Is that something you think we'll see in the near term? Where do you think we are in the cycle in terms of rates that would get you to make that that move? That's a little bit different than maybe Kevin had talked about in the past.

Kenneth Hvid: Yeah. Obviously every quarter we one quarter further into the cycle, right. But sitting here at the winter and looking at the liquidity and the number of time charters that are being done, we're comfortable with the continued exposure to the spot market, but of course, selectively, yeah, it would make sense. There isn't a ton of liquidity. There aren't a lot of one, two or three year deals that are being done on time charter at the moment. So we just need to get a bit further into the winter to see how those opportunities will arise. But it's been a fairly quiet Q3 when it comes to opportunities in that respect. But it's something we're looking at constantly.

Ken Hoexter: On the flip side, do we keep watching the time charter ins fade away then if we're not seeing much time charter activity?

Kenneth Hvid: Yeah. That's an option as well. At a price point, we're there where everybody's watching this market equilibrium. And that's always an interesting time. And that's where we say, "Okay. Well, at the right levels, we would put some vessels away on time charter without giving you the exact number here." But at the same time, given that we have a very low cash flow break even, we can also stomach keeping on the exposure to what we still think should be a pretty healthy winter here, and then see where next year goes.

Ken Hoexter: Great. Appreciate it. Thank you.

Kenneth Hvid: Thanks, Ken.

Operator: And that does conclude the question and answer session. I'll now hand the conference back over to the company.

Kenneth Hvid: Well, thank you very much for listening to our earnings call today. We look forward to reporting back to you next quarter. Have a great day.

Operator: Well, thank you. That does conclude today's conference. We do thank you for your participation. Have an excellent day.