TANKER INVESTMENTS LTD Q1-2016 EARNINGS RESULTS

Conference Call Transcript

Moderator: Emily Yee
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Operator:	Welcome to Tanker Investments Limited's First Quarter and Fiscal 2016 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. William Hung, Tanker Investment Limited's President and Chief Executive Officer. Please go ahead, sir.
Scott Gayton:	Before Mr. Hung begins I would like to direct all participants to our Website at www.tankerinvestments.com where you will find a copy of the first quarter of 2016 earnings presentation. Mr. Hung and I will review this presentation during today's conference call.
	As a reminder, this presentation contains forward-looking statements. Additional information on those forward-looking statements is contained in the first quarter of 2016 earnings release and earnings presentation available on our Website.
	I will now turn the call over to Mr. Hung to begin.
William Hung:	Thank you, Scott. Hello everyone and thank you for joining us today for Tanker Investment's First Quarter 2016 Earnings call. I'm here today with Scott Gayton, Tanker Investment's Chief Financial Officer. And for the Q&A session we have Brock Wlad, Director of Group Reporting for Teekay Corporation.
	During today's call I will be taking you through Tanker Investment's first quarter of 2016 earnings presentation which can be found on our Website.

Beginning with our recent highlights on slide three of the presentation, during the first quarter of 2016 Tanker Investments reported a net income of $18.7 million or 58 cents per share. We generated approximately $32.8 million of cash flow from vessel operations, or CFEO, this quarter, up slightly from $30.1 million generated during the same period of 2015.

Since January 1, 2016, the company has repurchased 3.3 million shares for $31.8 million and we still have approximately $33 million remaining from the existing forward authorization. It should be noted that during the next few weeks we intend to cancel the 8.1 million shares, or approximately 21% of the company, repurchased since October 2014.

Our OpEx declined by approximately $5 million, as expected, with the majority of this due to lower pre-delivery and takeover costs and other services experienced during the fourth quarter of last year. Going forward, we expect OpEx to decline slightly from this level due to the sale of the two VLCCs in mid-January.

Rates to date this quarter have been booked at lower levels than previous periods and I will address a few of the reasons why for this weakness during my sequent remarks.

And finally, the vessel sale and purchase, or S&P markets, are currently suffering from a lack of liquidity from modern vessels which has created a negative sentiment on asset values at this point in the cycle. With this backdrop, we need to take steps to ensure we are in a healthy financial position should the S&P market continue to be illiquid.

Lastly, it’s important to point out that selling the fleet remains a top priority for management and the board.

We look at the developments in the crude tanker - the crude tanker market remains well supported by a strong oil supply and demand fundamentals. However, midsize tanker earnings were impacted by a number of factors during the first quarter of 2016 resulting in a decline in tanker rates compared to the same period last year.

Firstly, a period of heavy refinery maintenance to make up for the work which had been deferred in 2015 led to a reduction in refinery throughput, particularly in Europe. However, this should start to ease in the next two to three months as refiners come back online as shown by the chart on the right hand side.

Secondly, rising bunker prices, as a result of higher oil prices, weighed on tanker earnings during the quarter from a low of $125 per ton in January, bunker prices increased $170 per ton by the end of the quarter. This equates to around $1500 per day in additional voyage costs for an Aframax and approximately $2000 per day for a Suezmax.

Finally, regional supply disruptions in the Atlantic Basin, and particularly in Venezuela and Nigeria, had a negative impact on Aframaxes and Suezmaxes which traditionally load in these regions. This has led to a decline in Atlantic earnings though the Pacific market continues to be well supported by high exports from the Middle East and very strong imports demands in China and in India.

Turning to Slide 5, we take a look at tanker supply and demand fundamentals for the remainder of 2016. Starting with demand, raising oil consumption and ongoing stockpiling programs in China and India are expected to drive both oil and crude tanker demand during 2016. Demand in India rose by .4 million barrels per day in the first quarter, more than any other country in the world. Together, China and India account for 55% of the total year on year increase in global oil demand during Quarter 1.

In addition, licenses were granted to 11 Chinese teapot refinery in recent months allowing them to import crude volumes from global producers directly. The result has been an increase in Pacific Aframax demand as teapot refineries opt for smaller parcel sizes and significant port delays which help to tie up tonnage and tighten fleet supply.

We believe this change in government policy will have a significant positive impact on Chinese crude demand particularly for midsize tankers going forward.

On the oil supply side, OPEC production reached a seven-year high of 32.8 million barrels per day in April, as Iranian production returned to pre-sanctioned levels. Both Saudi Arabia and Iraq continued to pump at near record levels as well.

However, the chart on the right illustrates that outside of the Middle East OPEC production is falling due to temporary supply outages in Nigeria and Venezuela. This could result in Atlantic Basin refiners sourcing longer haul Middle East barrels leading to an increase in overall ton miles.

In addition, US production recently dipped below 9 million barrels per day for the first time since 2014. While the natural replacement for lost production would normally be West African barrels, they may begin sourcing more Middle East volumes should supply disruptions from Nigeria continue.

As refineries come back online, this would prove to be positive to crude tanker demand but would also lead to more trading volatility, which is usually positive for tanker rates.

Turning to tanker supply on Slide 6, fleet growth in the midsize crude tanker space is expected to pick up at the end of 2016 and 2017. The Suezmax fleet is forecast to grow by 4.5% in 2016 and a further 8.5% in 2017 while Aframax fleet including LR2s is forecast to grow by 4% in 2016 and a further 4.5% in 2017.

Going further out, the order book drops off significantly due to a lack of new orders in the midsize tanker segment resulting in lower fleet growth. We continue to take a conservative approach to scrapping in our fleet forecast given the low levels we have seen in 2015, hence the high fleet growth numbers for 2016 and 2017.

However, we must look at the age composition of the fleet, how fleets are trading within the existing fleet, and what the future regulatory landscape holds for internationally-trading vessels in order to fully understand the change in fleet supply.

As the chart on the bottom of the slide illustrates, the pool of older vessels, which includes all vessels age 15 years and older, is greater than the number of vessels currently on order. While we expect that another year of firm rates may deter owners from scrapping in 2016, there are headwinds in the near term such as oil major discrimination on older vessels and increased legislation such as ballast water, will impact owners’ decisions on spending additional costs on older tonnage at dry dock.

Turning now to Slide 7 I will provide an update on spot tanker rates for the first quarter of 2016 to date. As mentioned earlier, rates have come off the highs experienced in the prior quarter and are slightly lower than the rates earned in the second quarter of 2015. We have booked approximately 50%-60% of our revenue days at the rates indicated in the dark blue bars on the right hand side of the chart.

I will now turn the call over to Scott Gayton.

Scott Gayton: Thank you. Looking at Slide 8, as Will mentioned previously, there has been a lack of liquidity and the sale and purchase market for modern assets in part due to a lack of capital. While we have not deviated from our strategy, we are still looking for ways to capitalize on our investments to create shareholder value.

Selling ships directly into the sale and purchase market is challenging today, however, we were able to sell our two VLCCs in December and we will continue to evaluate all opportunities.

Tanker Investments still represents a compelling investment for existing and new shareholders. As can be seen in the graph to the left of the slide, with our low breakeven and high operating leverage, we expect to continue generating strong cash flow and any uptick in rates will have a meaningful impact on the cash on cash returns that accrue to our investors.

For example, if Aframax rates were to average $20,000 per day for the next year this would represent cash available for distribution of approximately NOK 14 per s hare representing a 22% cash on cash return to investors who bought our stock yesterday at NOK 64 per share.

This is an important metric because given the uncertainty of our cyclical market, we need to retain a portion of our cash flow within the company to delever our balance sheet. Looking to the chart on the right hand side of the slide, on a book capital basis our leverage is currently 46% which is down significant from 56% at the start of this year.

Furthermore, given our ability to generate cash flow, as I discussed earlier, and as the red, green and blue lines indicate, we expect our leverage will decline further by the end of the year depending on the tanker rate environment.

And if we are able to sell ships, and/or the rate environment is stronger than we anticipate, and we're able to delever faster, than as we have done in the past, all excess capital will be distributed to shareholders in the form of share repurchases or dividends.

I will now turn the call over to Will to conclude.

William Hung: Thank you, Scott. Summing up, a lack of liquidity for the modern vessels have created nervousness in the sale and purchase market driven purely by sentiment versus executed transactions, but we remain positive and encouraged by the strong supply and demand fundamentals which continue to create a positive spot rate environment for crude tankers.

Although rates in the near term have been impacted by supply outages, in the longer term we believe that changing trade patterns to account for these outages will lead to increasing rate volatility and firm rates throughout 2016.

Operator, we are now available to take questions.

Operator: Thank you. If you would like to ask a question please signal by pressing star 1 on your telephone keypad. And if you're using a speakerphone please make sure your mute function is turned off to allow your signal to reach our equipment. Again press star 1 to ask a question. And we'll pause for just a moment to allow everyone an opportunity to signal for questions.

And our first question Eirik Haalvadsen from Pareto Securities. Please go ahead.

Eirik Haalvadsen: Yes, hi. You say that the fleet liquidation remains the top priority. Can you be a bit more specific because I think you also in your market comments now talk a bit more about kind of the market beyond 2017. So is it sort of also an option here to just stay through the cycle in a way or are you more specifically looking at selling ships today?

William Hung: Hi, Eirik. Thanks for the question. We are - we have a change of strategy. We are continuing to look at all opportunities in terms of selling ships either one by one or on block or the whole fleet. But as I said earlier, what we need to do is we need to be a little bit more creative and innovative in looking at different deals now because the market is illiquid. So in a way we need to create - we have to create the market ourselves and we are seeing opportunities out there here - out there right now that we're evaluating. Does that answer your question?

Eirik Haalvadsen: Yes. Yes, no that's okay because I assume you also take kind of the level of where your stock is trading into account there so obviously, you know, selling ships below lost (done) and well below lost (done) is painful. But considering also where your equity trades it's - it should be accretive regardless. But you also comment that, you know, the recent supply disruption was in the Atlantic or could be positive in a way for seeing Atlantic buyers to turn to longer haul volumes.

But couldn't it also be the other way around that it would, you know, force short - longer haul buyers of Atlantic crude to buy nearer haul volume from the Middle East, isn't that also the potential outcome here? And how do you also see this on a midsize versus, you know, basis, the disruption with in particular Nigeria right now?

William Hung: No, Eirik, you make a good point. I think it's a timing issue that we're talking about right now. You're right, it could have a negative effect but like I said if it lasts a bit longer than the US is going to have to source - US and Europe are going to have to source their crude from somewhere if Nigeria continues to be down for a longer period of time. And that would mean that it would have to take it from the Middle East. So, again, it's about a timing issue here.

In the short brief term right now, yes, it could - we are taking a hit. But as we're coming out of refinery maintenance in the US and Europe right now, and they're going to be demanding for more crude to start to increase their throughput, they're going to have to look for other sources and that's going to be the Middle East and that's going to be longer time miles. Does that make sense?

Eirik Haalvadsen: Yes, it makes sense. I'm finally...

(Crosstalk)

William Hung: Actually the other thing that I just - before I came into the call - Exxon just restarted their production in Nigeria through their pipeline damage so they're back up and running already which is expected to be about 320,000 barrels per day that's back up. So we're already seeing changes...

Eirik Haalvadsen: Okay.

William Hung: ...in the dynamics already.

Eirik Haalvadsen: Okay. I'm finally on, as you previously mentioned, you want that 50% leverage figure before you start considering dividends. But again, given where the stock trades, do you want to give a comment on whether you have any sort of minimum threshold in terms of NAV discount before you consider dividends or is that still going to be something you evaluate at the time?

Scott Gayton: Yes, hi, Eirik. Yes, we will be considering probably more at the time that we are in an excess capital position whether it's going to be dividends or it's going to be buybacks. But what I will say is that the target has probably moved from being in that 50% range down now more into the low 40s as we've shown on that graph.

Eirik Haalvadsen: Okay so you want to have even low - why is that really? Can you say why a bit more specifically?

Scott Gayton: Sure. I think as we laid out in the presentation and Will had mentioned that, you know, due to the lack of clarity into the S&P market at the moment, and with no clear view as to when this changes, we need to ensure that we've got the financial runway, you know, to wait until those markets open.

Eirik Haalvadsen: Yes, but I mean, compared to a lot of other tanker companies I think you have a, you know, you have no CAPEX commitments, you have a relatively sound balance sheet, you have modern ships that, you know, in the - even in the weakened market you could at least be able to sell them yet at a lower level than what was the case six months or12 months ago. But still, I mean, why be more conservative on the dividends which, you know, could be a way to visualize the low level your stock trades at?

Scott Gayton: Yes, well I think it has to do with that lack of clarity into the S&P market because we can no longer count on that to act as a source of delevering like we could earlier when we were at 56% which was well above our targets but we knew that we had access to sell the ships and we were able to use some of the cash flow to delever.

And now we're going to have to use our cash flow to accomplish this goal. You know, but once we do, you know, get into those targeted leverage range then we will be looking at returning cash to shareholders. We just need to - nobody knows then the markets will open up, the sale and purchase markets will open up and so therefore we need to plan and have a long enough runway that we're able to take advantage of that in the future.

Eirik Haalvadsen: All right but, I mean, as you show you have breakeven after interest expense and ((inaudible)) $12,900 which I think is very low in the industry, you know, even in the weakest markets rates weren't down there for a long period of time. So isn't this taking a very conservative stance to, you know, giving shareholders, you know, something back as buybacks obviously haven't been working.

Scott Gayton: Yes, but we also have to remember on top of that you've got about $6000 a day in debt amortization that we need to make over, you know, through that time period so you're all in breakeven including dry dock interest and debt amortization is around $20,000 a day.

Eirik Haalvadsen: All right okay thanks for this.

Operator: Once again, ladies and gentlemen, if you have any additional questions at this time please press star 1 on your telephone keypad. Again it is star 1 for questions. And your next question will come from the line Øvind Berle of DNB Markets. Please go ahead.

(Nicolai): Hi, this is (Nicolai) DNB speaking. Could you comment about, you know, you say that there is low liquidity in the sale and purchase market but isn't typical when your policy asset peak and values start moving down? I mean, saw some transactions here in May, you know, showing 10% below the official quotes. Could you say if there is higher interests in the sale and purchase market for your non-Chinese ships and how you differentiate that?

William Hung: Sure. Hi (Nicolai). So your question is that if the S&P market is coming off its peak that it makes sense that there is low liquidity, is that your question?

(Nicolai): Or since the bid-off spread could probably be wider when you're off - when you're off the past peak you could say that the bid-off spreads widen but you saw some transactions on Suezmaxes, you know, printing 10% below lost (done), to what extent are you just holding off as you probably were characterized in the upswing that you were too slow on accumulating tonnage, that, you know, could be too greedy on the way down by selling assets?

William Hung: I'm sorry, can - I didn't see any modern vessels being sold recently. Have you seen that, (Nicolai)? Because I think what you're referring to is the older Suezmaxes that have been sold and that has been a liquid market because people acquiring the older ship vessels have not been reliant on the capital markets to open up. So the modern vessels that we have talked in our presentation, that market has been very illiquid.

So we have a disagreement here in terms of if the market comes off that the market is liquid. It actually when you see the market bracing, when you see the market moving up it's actually a quick market; when you see the market coming down people usually see transactions as well.

What we're having the problem right now in the S&P market and the illiquidity is not so much about market fundamentals, as I had mentioned in our presentation. Market fundamentals are strong. You're looking at oil production in the Middle East being a seven year high. You're seeing oil demand, China and India, being high. So the market fundamentals are strong, it's the capital markets for right now that are making the shipping markets or the S&P market illiquid.

And I don't agree with you in terms of we were slow in acquiring assets and then being greedy now as you say it. I think we are looking at examining every opportunity, we are looking - we are talking to all the buyers out there. We have demonstrated at the end of last year and in January of this year, we have sold and delivered two VLCCs.

So we are sticking to our strategy and we are looking at alternative ways. And like I said earlier to Erik, being more innovative in the way that we look at getting - selling our assets.

(Nicolai): So if you think - if you - where would you say does the five-year old Suezmax is valued today in the current market?

William Hung: Well, I think if you...

(Nicolai): If you were to sell one today where you think it's reasonable given the latest developments? What would you think you could get for a five-year old?

William Hung: Well, (Nicolai), I think that as I had mentioned, we're talking and exploring a lot of opportunities right now. And if I talk about asset values right now that probably would not be a good idea where I think a five-year old vessel is. But you could probably look at different sources such as Clarksons and everybody else to give you an idea of what that value is.

(Nicolai): Okay. Thank you.

William Hung: Is that fair?

(Nicolai): That's fair.

William Hung: Okay.

Operator: Your next question will come from the line of Jeffrey Schwarz of Metropolitan Capital. Please go ahead.

Jeffrey Schwarz: Good morning, gentlemen. I am a shareholder and as such, I don't quite understand why you feel compelled to keep reiterating that the company is sticking with a strategy that was - that was adopted some number of years ago, that being a relatively short term asset play. The environment has changed and it's the responsibility of the board and management to have a strategy that can evolve with the change in the overall environment.

So as you have pointed out, the market fundamentals are strong today. The returns on assets are very strong using current market values for vessels. And I can't understand why the focus and fascination with looking to - trying to find creative ways of selling assets when, speaking for myself, I'm very happy with the returns that are being generated by the assets that we hold.

As you pointed out, the problem with valuations is most likely driven by illiquidity in the capital markets that makes it difficult for buyers to finance purchases. To me, that sounds like an opportunity to hold assets that are generating strong cash returns now rather than seeing ourselves as a fierce seller.

Scott Gayton: Hi, Jeff. Maybe I'll take a stab at that one. Thanks for your call and your question. I think that you're actually - we are agreeing on the - on what we're doing here. We are still evaluating all opportunities to try and fulfill the promise that we made to our initial private investors and then subsequently our public investors. But right now that is proving to be challenging. So we don't want to give up hope but ultimately we, you know, we do want to ultimately fulfill that goal.

While we are waiting and we're evaluating opportunities, we want to make sure that we are in the best financial position that we can continue to generate strong cash flows and ride out this market for as long as that may be. And that could be, you know, it's really hard to tell as to when the capital markets and the debt markets will open up for ship acquisitions and therefore liquidity will come.

But during that timeframe, you're absolutely right, we're generating strong returns, we're generating good cash flow and we will - we're, you know, we're quite satisfied to maintain the status quo for as long as we need until we do a transaction that actually makes sense for all shareholders. And I would characterize ourselves as being forced sellers. Any transaction that we look at to potentially sell the transaction, you're always going to put that up against, well what are we generating and what do we think we can generate into the future.

And if we think we can do better by maintaining and holding the fleet then by whatever the deal may be on the table we'll reject it and we will continue to do what is in the best interest of all shareholders from a return point of view.

(Crosstalk)

William Hung: Jeff, if I can just echo what Scott is saying, if we gave you the impression that we're - we have the - that we're being forced sellers here, we absolutely are not. The markets are good. We believe that 2016, the spot market is going to continue to be firm. And as Scott says, we're going to be financially prudent in making sure that we are able to last for a little bit longer so that we can find the right deal and add the maximum value for our shareholders. I want to thank you for your call, Jeff.

William Hung: Yes. Thank you for your response. And just a follow up from my perspective, $1 of, you know, as much as shareholders like to see cash returns, paying down $1 of debt and reducing risk in the balance sheet is, you know, does not destroy value. That's no worse than putting a, you know, $1 in the pocket of shareholders that - it just preserves the optionality for the company to ride through if it turns out that the environment, you know, doesn't remain as strong as it is now.

Scott Gayton: Yes, no thanks for, you know, thanks for pointing out that, Jeff. I was trying to make that point on that Slide 8 there that the value of the company is no different whether the cash is retained or whether it's paid out.

Jeffrey Schwarz: Okay, thanks guys.

William Hung: Thank you.

Operator: It appears there are no further questions at this time. Mr. Hung, I'd like to turn it back over to you for any additional or closing remarks.

William Hung: Well thank you, everybody, for joining our call today, and I look forward to talking to you next quarter. Thank you very much.

Operator: And this concludes today's call. Thank you for your participation. You may now disconnect your line.

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