Company: Tanker Investments Ltd

Conference Title: Tanker Investments Ltd. Fourth Quarter and Fiscal 2016 Earnings Results Conference Call

Date: Thursday, 23rd February 2017

Operator: Welcome to Tanker Investments Limited's Fourth Quarter and Fiscal 2016 Earnings Results Conference Call. During the call, all participants will be in a listen-only mode. Afterwards, they 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 zero to register for a question. For assistance during the call, please press star zero on your touchtone 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 Investments Limited's President and Chief Executive Officer. Please go ahead.

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 Fourth 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 Fourth Quarter of 2016 Earnings Release and Earnings Presentation, available on our website. I will now turn the call over the Mr. Hung to begin.

William Hung: Thank you, Scott. Hello everyone, and thank you for joining us today for Tanker Investments' Fourth Quarter 2016 Earnings Call and Presentation, a copy of which can be found on our website. I’m here today with Scott Gayton, Tanker Investments’ Chief Financial Officer and for the Q&A session, we have Elize Nel, Director of Group Reporting for Teekay Corporation and Christian Waldegrave, Head of Research for Teekay Corporation.

Beginning with our recent highlights on slide 3 of the presentation, we have reported a net income of $2.7 million or $.09 per share and a generated cash flow from vessel operations, or CFEO, of $16.6 million, all of which are up from last quarter due to stronger tanker rates.

In order to offset some of the headwinds we expect in 2017, we have secured a 12-month time charter for the Aframax Tarbet Spirit at a rate of $17,000 per day. This is in addition to the 12-month time charter on the Aframax Emerald Spirit, which we concluded in October of last year. Management will continue to look for time charter opportunities throughout the year. However, we expect that the headwinds that we may face in 2017 to be short-lived as we see improving tanker fleet dynamics and longer trade routes developing as we head into 2018. Finally, as Scott will discuss in more detail later, Tanker Investments is financially well positioned to weather the tanker market in 2017.

Turning now to slide four, we look at developments in the spot tanker market. The tanker market had a strong finish in 2016 as normal winter seasonality was supported by a number of positive supply and demand fundamentals. OPEC crude oil production hit a record high in the fourth quarter of 2017 and demand was supported by the desire to stockpile oil ahead of OPEC supply cuts. Global refinery throughput was high during the winter months, which further supported tanker demand. Finally, a recovery in exports from Nigeria and Libya lead to more cargoes in the Atlantic Basin, which was positive for both Suezmax and Aframax demand.

As mentioned in the previous slide, we do anticipate some headwinds in 2017. Firstly, OPEC has announced supply cuts of 1.2 million barrels per day starting January of 2017, and early indications are that compliance with these cuts is high; this is negative for owners that rely on cargoes originating from the Middle East region. However, this if offset by an increase in longer-haul tanker movements from the Atlantic to the Pacific, as Asian buyers look to alternative sources of crude. I will talk more about the increased long-haul movements later in this presentation.

Secondly, the rebalancing of oil markets as OPEC cut volumes will likely result in a higher oil price and a flatter crude future curve causing refiners to drawdown on inventory and leading to a slowdown in strategic stockpiling during 2017. Furthermore, oil prices have increased to around $55 per barrel in early 2017, which will have an impact on bunker prices.

Finally, tanker-fleet growth is likely to remain elevated in 2017 with the mid-size tanker fleet growing by around 5%. Growth is projected to be higher in the Suezmax segment, where there is a large delivery schedule in the first half of the year.

Turning to slide five, we explain why we believe the soft market in 2017 will be short-lived. After two years of virtually no scrapping, the mid-size tanker fleet is ageing. As shown by the chart on the top right of the slide, one third of the mid-size fleet reaches 15 years of age or older by 2020. And there are a large number of late 1990s-built and early 2000-built vessels which will become scrap candidates in the next few years.

The implementation of new environmental regulations such as ballast water could also spur an increase in scrapping due to the extra CAPEX associated with installing treatment systems. While the IMO regulation does not come into force until September of 2017 and many vessels have short-term exemptions from the US Coast Guard, we believe that from 2018 onwards, it will become much more difficult to avoid this regulation and that owners will be forced to install these systems at a cost of over $2 million per vessel. As such, we believe that the tanker scrapping could accelerate from 2018 onwards, which will be positive again with the tanker market.

In addition to higher scrapping, we believe that a lack of new tanker ordering will also keep fleet growth low. In fact, new tanker ordering in 2016 was the lowest since 1995 as a lack of available financing and an increased spread between new building and second-hand prices kept owners away from the yards.

Going forward, we already see a rationalisation of shipyard capacity that will result in permanent reduction in production and supply. To be specific, we are seeing northern Chinese new building construction yards, as well as yards in the Shanghai region, being sold and rezoned for residential construction. In Korea, we are seeing a similar trend in Busan as well as new building floating docks being sold to third-party Chinese buyers for repair and dry-docking purposes. Hence, we believe the end of the decade will likely be a period of low tanker-fleet growth, which should be positive for fleet utilisation and rates.

Turning to slide six, I want to take a moment to talk about the changing tanker trade patterns and how this will benefit mid-size tanker markets in the next few years. The map shows an increase in oil demand East of Suez in the next five years, particularly in countries like China and India where the Atlantic Basin has increased supply of oil, particularly in North America. We therefore believe that the coming years will see a renewed increase in long-haul crude exports of the Atlantic Basin heading to Asia, regardless of OPEC policy.

In fact, we can already see some of these changes at play with Atlantic Basin exports to Asia increasing by 25 million barrels since October of last year. In the US, crude oil production is starting to turn around as an increase in oil price is supported renewed drilling activity. In addition, US crude is attractively priced compared to other crudes, particularly as OPEC production cuts have forced the price of Middle Eastern grades.

This has resulted in an increase in US crude export recently, with exports hitting a record high of a million barrels per day last week. Some of this is going to Europe and Americas, but a growing portion is heading to Asia on Suezmaxes. This is very positive for mid-size tanker ton-mile demand. While combined with the growing exports out of Brazil and recovery in volumes from Nigeria and Libya, we believe the Atlantic region is re-emerging as a major supplier of oil to the Asian markets.

In sum, we believe the tanker market will face some near-term headwinds in 2017 and TIL have actions to navigate through this. However, we believe any downturn will be short-lived, and we are excited about the prospects of the tanker market going forward due to a combination of low fleet growth, strong demand growth fuelled by an increase in long-haul tanker movements.

Turning now to slide seven, tanker rates remained strong during the first part of 2017, as can be see with the dark blue bars. So far this quarter, we have booked approximately 60% of our spot Suez and Aframax days at approximately $26,000 and $18,000 per day, respectively. However, since that time, both Suezmax and Aframax tanker rates have come off; hence we are seeing the value in the Aframaxes we have time chartered out. In addition, as of quarter one of 2017, we have moved the two coded Aframaxes, the Hovden Spirit and the Trysil Spirit, into the dirty Aframax RSA.

I would now like to turn the call over to Scott to discuss Tanker Investments' financial position.

Scott Gayton: Thank you, Will. Turning to slide eight, we believe Tanker Investments is financially well positioned with approximately $110 million of cash in undrawn revolvers and an overall conservative leverage profile of 43.6%. We have no debt covenant concerns and our facilities are suitably long-term, with our next maturity not until 2019. We have minimal cash outflow for dry docks of only 3 million with only two dry docks scheduled for 2017 and none in 2018. In summing this all up, we have a very low cash breakeven of only $11,400 per day, including OPEX overhead and interest costs.

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

William Hung: Thank you, Scott. As we have acknowledged throughout 2016, we anticipate 2017 will encounter headwinds. However, Tanker Investments is both operationally and financially well positioned to take advantage of what we believe to be the start of a stronger market beginning in 2018. Operator, we are now available to take questions.

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

We'll go ahead with our first question from Magnus Fyhr of Seaport Global. Please go ahead.

Magnus Fyhr: Hey, good morning guys. Just starting with the time charter that you did at 17,000 a day. What is the liquidity to do more time charter at that rate? Because that's seems like a pretty decent rate given the current headwinds facing the market.

William Hung: Hi, Magnus. Yeah, we're pretty happy with the time charter on the Tarbet Spirit that we just announced there. We're – I think the timing of it was pretty good; we were able to capture it when the rates were high and they're coming off right now. Liquidity-wise, as it - the spot market has come off, so the time-charter opportunities have gone down as well. But as I had mentioned during the call here, we do think that coming into 2018, the market's going to be – going to recover and be better. So I think what we're going to be looking at in terms of time charter in 2017 is probably shorter time charters and looking at quarter by quarter and seeing where we see the dips and trying to cover some of that stuff off. Does that make sense to you?

Magnus Fyhr: Yeah, no that's fine. And I guess with lower rates during the summer, it's probably difficult to lock in higher rates. What – you know, you only have two coded Aframax tankers; I mean, they're all trading dirty now – what's the thought there? I guess, you know, the product tanker market is facing their own headwinds but, you know, are they going to stay, you know, trading dirty for the time being or do you see opportunities there? And I guess my question is how do you view the crude tanker market vis-à-vis the product tanker market going forward?

William Hung: That's right, we have moved both ships into the Aframax RSA now. And the reason why we did that was just looking at the forward market here in our view on how the crude side for Aframaxes is going to perform compared to the clean side on the LR2s, and our view over the – at least over the next 12 months is the crude side's going to outperform. So that's why we did that.

Magnus Fyhr: Okay, last question regarding dry dockings. You mentioned you only have two in 2017. How are you thinking about them? Are you going to address the water ballast treatment system or is that something you could postpone?

William Hung: What we did with those is because we had planned in advance, we had actually applied with the US Coast Guard for the exemption or the waivers, so we have been granted that. So what we're able to do now is because we're dry docking the ships this year prior to 2018, that now – once they're dry docked, we don't have to worry about the ballast water treatment system until the first dry dock or the first IOPP after 2018. So basically, in layman's terms, we have about a five-year grace period after this docking.

Magnus Fyhr: Okay, and I guess next year, I don't know if you provide it in the guidance for dry docking but I guess you will have – I don't know, how many dry dockings do you have? It doesn't look like you have – a pretty light schedule in 2018, as well.

William Hung: Yeah, no, so because we planned the fleet in advance and moved things around, we have zero dry dockings in 2018.

Magnus Fyhr: Okay, very good. That's all I had, thank you.

William Hung: Thank you.

Operator: And once again ladies and gentlemen, if you'd like to ask a question, please press star one on your telephone keypad. And it appears that there are no further questions at this time. Gentlemen, I'd like to turn the conference back to you for any additional or closing remarks.

William Hung: Well, thank you everybody for calling in today and I look forward to talking to you next quarter. Thank you.

Operator: This concludes today's call. Thank you for your participation. You may now disconnect your lines.