SemGroup Corporation

Second Quarter 2017 Earnings Call

August 7, 2017 at 11:00 a.m. Eastern

CORPORATE PARTICIPANTS

Alisa Perkins – *Head Of Investor Relations*

Carlin Conner – *Chief Executive Officer*

Bob Fitzgerald – *Chief Financial Officer*

PRESENTATION

Operator
Good morning, ladies and gentlemen. Welcome to SemGroup Corporation's Second Quarter 2017 Earnings Conference Call. As a reminder, this call is being recorded. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star then one on your telephone keypad. To withdraw your question, please press star then two.

I would now like to turn the call over to SemGroup's Head of Investor Relations, Alisa Perkins. Please go ahead.

Alisa Perkins
Thank you, Brian. Good morning, everyone. We are glad that you could join us today for our second quarter conference call.

I hope that you have had a chance to review our press release and earnings presentation which can be found on our website. I'd like to remind everyone that today's presentation may contain projections, forward-looking statements and certain non-GAAP financial measures. We encourage you to read our full disclosures in our latest press release, slide presentation, and SEC filings for a discussion of those items. These materials contain reconciliations to GAAP financial measures.

Hosting the call today is Carlin Conner, our CEO; Bob Fitzgerald, our CFO; and Dave Minnielly, Vice-President of Crude. With that, let me turn the call over to Carlin.

Carlin Conner
Thank you, Alisa, and thanks to everyone for joining us today for our second quarter update. This summer has been eventful, so we have a lot to cover this morning. Our second quarter results were up slightly from the first quarter and tracked expectations. Bob will go into more detail on our performance results shortly. Before that, I would like to take a step back and look at how we are executing on our strategy.

Slide 4 of our presentation outlines accomplishments and progress made since our conference call last quarter. To fully appreciate the scope and intention behind these highlights, we need to go back in time almost three years. That's when we recognized the critical need to balance our portfolio in the face of a lower [indiscernible] crude price environment. At that time, we designed and embarked on a very clear strategy to stabilize our cash flows and become less dependent on producer balance sheets and commodity prices. Our initial focus was to find a way to access the downstream who were finally facing market on the Gulf Coast.

Second, we committed to grow our midstream operations in areas where we could leverage our existing footprint while improving contract quality.

Thirdly, we committed to pursue M&A opportunities that would further advance our strategy.

Fast forward to where we are today. During the past month, we successfully completed the construction of the Maurepas Pipeline project. We also closed the acquisition of Houston Fuel Oil Terminal Company, also known as HFOTCO, one of the largest oil terminals in the US. This acquisition establishes SemGroup's position on the Houston ship channel.

Carlin Conner (continued)
Slide 5 goes into more detail around last month's HFOTCO acquisition. With respect to the financing, we are focused on funding the second payment as quickly as possible in a way that minimizes long-term costs to SemGroup. As mentioned on our HFOTCO call we have a number of options we are considering. These include non-core asset sales, joint ventures, and structured equity. Funding a portion of the second payment with a large, common equity offering is always an option. However, it is an option that is not preferred nor expected, given today's market environment.

While we do have these remaining, financing decisions to work through, I can't emphasize enough how excited we are to add this asset to our portfolio. HFOTCO is a versatile, growing, and independent, deepwater terminal. It provides a foundation of secure cash flows that are not dependent on elevated commodity prices. It strategically positions us as a critical service provider to the US Gulf Coast energy market and provides dynamic growth options that are driven by exciting new supply chains. When you consider the recent completion of Maurepas, combined with the HFOTCO acquisition, we now have a secure foundation of cash flows that are agnostic to commodity prices and do not require extensive capex to maintain. These two transformational projects will deliver portfolio balance and a new source of capital for both reinvestment and dividend growth.

The integration of HFOTCO is going well. We are extremely pleased with the early commercial momentum. In addition, we are pleased to advise that the full team has been retained. This year's contract renewals are largely complete and the extensive growth projects are on schedule and on budget.

In addition, multiple opportunities are being pursued to further grow our presence around HFOTCO. We firmly believe that this unique and versatile asset, serving a market and region that is evolving, creates extensive optionality which will drive value appreciation.

Turning to Slide 6 for a more in-depth update on our key projects. As I stated, construction on all three pipelines in the Maurepas project is now complete. The 24-inch crude line is operational and cash flowing. The two intermediate pipelines are completed and expected to begin contributing EBITDA in September.

I want to highlight how proud we are that our experienced engineering and operations team successfully overcame a number of challenges, including permitting delays and a 45-day work closure this summer due to weather-related issues.

In Oklahoma, we continue to make progress on our two, new STACK pipelines and expect to complete construction by early first quarter. Both projects are batched out by long-term contracts with investment grade counterparts.

In addition, SemGas recently contracted with an additional customer to transport gas on the Canton pipeline to the Rose Valley gas processing complex. This additional agreement is backed by a long-term, acreage dedication from a producer. Both pipelines will leverage existing asset capacity, driving capital return efficiencies. We fully expect to continue to announce additional customer commitments that will further enhance our returns.

In Canada, growing demand for our latent sulfur recovery capacity and capability is driving significant opportunities with well-capitalized producers. Our SemCAMS team continues to make progress towards further commercialization of our previously announced Wapiti plant. This plant will add to our Duvernay and Montney footprint.

In addition, we're reviewing other pipelines and processing expansions in this highly active region. We

Carlin Conner (continued)
are now looking at extending our Wapiti footprint north. If there is ample interest, we envision constructing a new plant in the 2019/2020 timeframe. Ongoing projects at HFOTCO are on schedule and on budget. If you recall, the team in Houston is building its fifth deepwater dock, an additional 1.45 million barrels of crude tankage, which is backed by a long-term, take-or-pay contract with an investment grade counter-pull.

Now, I'd like to turn the call over to Bob who will discuss our financial results in more detail.

Bob Fitzgerald
Thank you, Carlin. Starting on Slide 7, SemGroup reported net income of $9.6 million, compared with the net loss of $10.3 million in the first quarter. The first quarter was negatively impacted by a nearly $20 million charge related to the refinancing of bonds. As announced earlier this morning, the SemGroup Board of Directors declared a quarterly cash dividend to account shareholders of $0.45 per share, resulting in an annualized dividend of $1.80.

SemGroup posted second quarter consolidated adjusted EBITDA of $55.4 million, up nearly 8% from $60.7 million the prior quarter. Earnings for all three of our crude segments were essentially flat in the second quarter compared to the first quarter. In our Crude Transportation segment, White Cliffs volumes were down slightly quarter over quarter while remaining at the high end of our expectations. We continue to expect White Cliffs volumes to average 100,000 to 110,000 barrels per day for the year.

Glass Mountain Pipeline's contracted volumes were up sequentially, due primarily to the step up in shippers minimum buying commitment in April.

Crude supply and logistics adjusted EBITDA was flat quarter over quarter, as we continued to experience compressed margins in key marketing regions and were negatively impacted by inventory cost timing. The planned logistic volumes were down sequentially as the first quarter volumes were elevated, due to scheduling constraints at a third-party terminal.

Turning to SemGas, adjusted EBITDA was up slightly from the previous quarter, largely due to a one-time contractual true-up of $2.5 million, partially offset by lower volumes. Currently, two rigs are operating in the acreage dedicated to our plant, which is slightly below our initial expectations. We have lowered our forecasted volumes of approximately 7% for 20 million cubic feet per day to 260 to 280 million cubic feet per day. We expect to see contributions from the Canton Pipeline project starting in the first quarter of 2018.

SemCAMS adjusted EBITDA was up about $3.4 million sequentially as the current quarter benefited from a $4 million annual true-up of minimum buying commitments. For the remainder of the year, we are anticipating that customers will be shipping at or above their taker payload. During the second quarter, we had a planned turnaround at our K3 plant which lasted approximately four weeks and was completed on time and on budget. Overall the turnaround negatively impacted the quarter by approximately $1 million because we were able to move some volumes to our KA plant and we captured higher cost recoveries.

With the continued development around our assets, we have increased our anticipated [indiscernible] volumes by nearly 6% to a range of 400 to 420 million cubic feet per day.

SemLogistics posted adjusted EBITDA of approximately $3 million, down $800,000 compared to the prior quarter due largely to seasonal decrease and throughput volumes. SemMaterials Mexico EBITDA was relatively flat quarter over quarter, reflecting the continued constraints in the Federal Government's road

Bob Fitzgerald (continued)
construction budget.

Moving to Slide 8, our leverage and liquidity position, SemGroup entered the quarter with a net compliance leverage ratio of 3.7 times compared to our target of 4.5 times and our maximum covenant of 5.5 times. Our total liquidity as of June 30th was approximately $850 million. As previously noted, SemGroup closed the acquisition of HFOTCO on July 17th. SemGroup funded the initial $1.5 billion consideration by assuming $761 million of HFOTCO net indebtedness and $301 million in cash, using the SemGroup revolving credit facility and issuing 12.4 million shares of SemGroup common stock.

Although not reflected in SemGroup's second quarter results, HFOTCO reported net compliance leverage as of June 30th of 6.8 times, compared to a covenant of 7.5 times. I'd like to point out a few items in regards to the HFOTCO debt structure, which is detailed out in Slide 16 of the presentation.

For the past several years, HFOTCO has operated with a higher leverage ratio, but has maintained relatively strong BB credit ratings from both agencies. This is in recognition of the strong, stable, and secure cash flows generated by HFOTCO's asset position and long-tenured customers. The ratings also reflect the fact that HFOTCO's debt structure includes $225 million of advantaged, tax exempt, low cost, Hurricane Ike bond that mature in 2050. We expect to keep the HFOTCO debt as a key component of our capital structure.

On a pro forma basis, our June 30th net leverage is 3.8 times calculated on our covenant basis, which includes the judgments for the $301 million revolver draw, as well as $70 million pro forma, last 12 months distribution from HFOTCO December. Our pro forma consolidated leverage ratio is 5.2 times. As Carlin noted earlier, we are evaluating options to fund the remaining consideration related to the HFOTCO acquisition that will not add incremental debt to the company.

In addition, we are evaluating other options that will further de-lever the company on a consolidated basis, including non-core asset sales, joint ventures, and structured equity. Post-acquisition our consolidated liquidity is nearly $630 million as of June 30th. We expect to trim out a portion of our revolver debt, later this year.

Turning to Slide 9, SemGroup is narrowing its initial 2017 adjusted EBITDA guidance to a range of $270 million to $290 million, due primarily to the continued softness in the crude supply logistics market and the timing of Maurepas cash flows. With the expected addition of $60 million of adjusted EBITDA, in connection with the HFOTCO acquisition, SemGroup is updating its 2017 adjusted EBITDA guidance to a range of between $330 million to $350 million. We expect to provide 2018 adjusted EBITDA guidance with our year-end results.

Management reaffirms that dividends will be reviewed annually in December of each year, targeting a 10% dividend CAGR through 2020. In December 2017, management expects to recommend to the Board of Directors a dividend increase of 10% on an annualized basis.

Now, on Slide 10 for our updated capital expenditures guidance. For the year, we expect to deploy approximately $575 million of capital expenditures, which now includes approximately $75 million in growth projects for HFOTCO which are on time and on budget. On a consolidated basis we expect to spend $60 million in maintenance projects.

I'll now turn the call back over to Carlin for some final comments.

Carlin Conner
Thanks, Bob. This summer marks incredible achievements towards our long-term goals. These achievements have laid the foundation for stable and growing cash flows going forward. Our portfolio is now generating significantly more secure cash flows that are insulated from crude oil price volatility while providing exciting new growth paths. Projects on the Gulf Coast, in the STACK, and Central Alberta provide a path to double-digit dividend growth while growing coverage and delevering. After a lot of hard work and persistence, our strategy is beginning to bear fruit. However, we are fully aware that to deliver shareholder value, we need to execute on these growth projects under construction, address the second HFOTCO payment in a timely manner and at the lowest cost, strengthen the balance sheet, and pursue additional organic growth off of our expanded and diversified platform.

With that, I'd like to thank you for your time this morning. I'll turn the call over for questions. Operator?

QUESTIONS AND ANSWERS

Operator
We will now begin the question and answer session. To ask a question, you may press star then one on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star then two.

The first question comes from Shneur Gershuni with UBS. Please go ahead.

Shneur Gershuni
Hi, good morning, everyone. I just wanted to talk about the financing plans on a go-forward basis and do appreciate some of the color that you provided today. When you talk about, in your slide deck, structured equity and so forth, I was wondering if you could give us examples of what you are thinking about. Do they have to be full equity credit from an agency perspective, or is it something that just must comply with your credit facilities? I'm just wondering if you can give a little bit more color on that if possible.

Bob Fitzgerald
Good morning, Shneur. This is Bob. I'll go ahead and take that. We've been evaluating different preferred equity structures, which we believe could help primarily pay off of the outstanding amount. We have not settled on any specific structure at this point, but based on initial discussions, we're pretty confident that there's a healthy appetite in today's market for preferred offering. It doesn't have to receive full credit from both rating agencies. Obviously, some of that preferred doesn't get full credit. But, we're looking through all those options today.

Shneur Gershuni
Okay. Just continuing on that, when you talk about potential JVs and partnerships and so forth, are you talking about newer/existing assets, like let's say Maurepas, or are you thinking about JV'ing on projects that are currently in construction.

Carlin Conner
Hi, Shneur, this is Carlin. We're looking at all of the above. We do have a pretty healthy backlog of capital. So, as we look forward in some of the bases where we're building, we're open to ideas of sharing that capital and bringing in partners. We're also available to discuss other interesting concepts around joint ventures and of course non-core asset sales.

I think it's important to point out we hired Evercore to help us in evaluating all of our options. I think if you listen to the call script, we're really focused on these three options of non-core asset sales, joint ventures, and structured equity.

Shneur Gershuni
Okay, just shifting to your results and so forth. One I was wondering if you can expand on the Maurepas delay. Then, secondly, with the Canton Pipeline that you announced last quarter, you had talked about the potential to get far and above the committed volumes that were there and the system would be expandable. Have you made any progress on further off-tick agreements that could lead to filling up the full capacity of your [indiscernible] system?

Carlin Conner
First, let me handle the Maurepas question. The delay from our last guidance on the project, that was really driven by weather constraints during this past summer. We had a very interesting occurrence of the Bonnet Carre Spillway, which is an important floodgate of the Mississippi River. It was open for only the 12th time in its 85-year history. That forced us to leave the work area for almost 45—it caused a 45-day delay. So, that pushed us back quite a bit, but we're happy to report that field work is done. We are now cash flowing on the crude system and will be cash flowing on the 6 and 12-inch in early September.

Shneur Gershuni
Okay. I was looking at—

Carlin Conner
Sorry? As far as Canton, I think your question was around the Canton gas system?

Shneur Gershuni
Yes.

Carlin Conner
As we talked about before, the initial set up for that system, $250 million a day of capacity which we could expand quite a bit with further compression. The good news is our base load customer, our first customer, investment grade, long-term counterparty has indicated that they will be—their gas profile is much more robust in the early stages, so we're actually going to be seeing more gas coming than we thought.

Then, as we mentioned in the script, we have added a second customer, a producer with an acreage dedication that is going to bring on some volume. So, we are definitely in the middle of commercializing that whole pipe. We have some exciting opportunities in front of us.

Shneur Gershuni
So, would you expect to bring the compression on sooner than originally thought?

Carlin Conner
Yes, I think we're definitely accelerating the compression.

Shneur Gershuni
Okay, perfect. Thank you very much, guys. I appreciate the color today.

Operator
The next question comes from Tristan Richardson with SunTrust. Please go ahead.

Tristan Richardson
Good morning, guys.

Carlin Conner
Morning.

Tristan Richardson
I'm just curious on the HFOTCO, you guys narrowed the outlook for the EBITDA contribution at HFOTCO just by a small amount. I noticed you guys said that outlook for 2018 and 2019 is on track. Just curious if that narrowing from $60 million to $65 million, down to $60 million, is that really just a function of the timing of the close?

Then, just secondly, you talk about contract renewals largely being complete at HFOTCO. Just curious, just generally speaking, how the contracting process works at HFOTCO.

Carlin Conner
Let me answer the contracting. As we talked about when we had the call when we announced the acquisition, HFOTCO has the resid business and the crude business. The crude business is largely underwritten by long-term contracts, and the resid business, you have long tenured customers that have been there for an average of over 50-plus years, but you do have these contract renewals that clip on every year. So, there is that pretty healthy maintenance of contracts that are ongoing. So, as we sit here in mid-2017, and we're one month into operating HFOTCO, we're very pleased with the contract renewals that have already occurred in 2017. So, we're very much on track.

As far as the $60 million versus what we said earlier—I think we said $60 million to $65 million, it has everything to do with the timing of the close.

Tristan Richardson
Perfect. Okay, that's great. Then, Bob, I think you alluded to this somewhat on your comments around the Canadian gas business, but just curious, the upward revision of the outlook there, is that purely a function of the KA plant capturing more than you expected while K3 was down? Or is it—could you maybe just comment on either producer outlooks changing? Just a little more commentary there would be helpful.

Bob Fitzgerald
Sure, Tristan. It really didn't have anything to do with the KA taking on some of the K3 clients during the downtime of K3. It was all about the aggressive drilling that's going on up in the Montney Duvernay. Really, it's happening in both areas. We're seeing a lot of volume coming down our Wapiti pipeline system into Q3. We're also seeing good development around the Duvernay area which is feeding into KA.

So, one thing I'd like to clarify, we had a true-up as we mentioned in the prepared comments in the second quarter for CAMS. That really pertained mostly to the second half of 2016 volumes that weren't delivered during that timeframe. Then, the annual true-up hit in the second quarter. Currently, those producers are all hitting their taker pay and actually going above that. We expect that to continue and that growth to continue, which is why we raised our volume guidance for the rest of the year.

Tristan Richardson
That's helpful. Thanks, Bob. Thanks, Carlin. Appreciate it.

Operator
Next question comes from Craig Shere with Tuohy Brothers. Please go ahead.

Craig Shere
Good morning. A couple of questions already answered here. Any comments about the potential size of the revolver term out and expectation of it remaining the—keeping the revolver size data going forward?

Bob Fitzgerald
I think probably with regards to the revolver size, Craig, I would say that, today, we think that the billion dollar revolver at SemGroup is fine. We do have some options around that with an accordion feature related to it.

As far as the size of potentially terming out some of that revolver, sitting here today, we're looking somewhere in the range of $300 million or $400 million, but that will depend upon the markets and what they looked like at the time we pull the trigger on.

Craig Shere
Okay, great. You talked about the NPCs already. So, how soon do you need to announce another plant further north in the Wapiti area to hit that 2019/2020 potential timeframe?

Carlin Conner
Hi, Craig. This is Carlin. That's a great question because, if you recall, we made the announcement on our current Wapiti plant earlier this year. It's not going to be ready until the first half of 2019. So, you can kind of use that as a measure. The project will take a lot of time up there, especially the permitting. Permitting is ongoing. We will hopefully have a FID sometime in the near future, but market and permit conditions will obviously dictate that.

Craig Shere
So, it's interesting. I mean, it sounds like an extremely positive call. You're talking about full steam ahead on accretive growth projects. At the same time, there doesn't seem to be a lot of concern about getting your arms around the backend payment on the latest acquisition and overall balance sheet leverage. Is it fair to say that you don't feel capital constraint relative to these accretive growth projects?

Carlin Conner
Well Craig, clearly we recognize the importance and we have prioritized the second payment. That's why we talk about trying to get that out of the way sooner than later. The bottom line is I guess that the confidence you may be hearing is that we have a plan. We've said that. We feel like with the options that we have and the feedback from the market already from these potential counterparties is fairly positive. We just—it is full steam ahead.

We clearly will be paying attention to the balance sheet going forward. Any big projects that have a longer term delivery of cash flows coming in will have to be managed within our balance sheet targets. If that means we have to joint venture some of those projects or find partners, we will do that, but we believe it's important to take advantage of the assets and the footprints that we have.

I mean, Canada, we've been sitting on that for a while. We're finally at a point where it looks like that asset will be paying dividends for us. We definitely want to be very careful of how we play it going forward. We don't want to appear to our customers that we're not ready to spend capex to follow them. We definitely want to tap into that growth.

So, I understood the question, but the full steam ahead is really because we have a plan for the second payment. We feel very confident about it.

Craig Shere
That's great. Last question, pertaining to the second payment, do I understand that you can prepay any portion of the $600 and you get a discount of basically a 5% rate of return on your money on anything prepaid? Could we have a solution in the second half, 2017, for a good portion of this rather than having to wait a long time?

Carlin Conner
Bob has been assigned that project. So, I'm going to kick it to Bob.

Bob Fitzgerald
Thanks, Craig. I think that you had it right. We get a 5% brand of discount off the $600 million payment, if we repay it before the end of 2018. So, we are focused on that. If we get it done sooner than later, we absolutely want to capture that. That was part of our positioning in our prepared comments, so we're not going to sit around. We're not going to wait till next year to do something. We're going to start taking action as soon as we can. So, we'd love to get it done as soon as possible to get a bigger discount.

Craig Shere
Great.

Carlin Conner
Craig, just to follow-up, we see those three options that we mentioned as most likely options at this point. We do not envision that any one of those options will solve it. We believe a combination out of those options will be the answer going forward.

Craig Shere
Great. I really appreciate all the color.

Operator
The next question comes from Ryan Levine with Citi.

Ryan Levine
Good morning. Two questions on the second HFOTCO payment, just to follow up on that last question. If a portion of it were to paid, i.e., half of it, would you receive the 5% discount on the half of the payment that was made, or do you only receive the discount at the entire liability or obligation is made?

Bob Fitzgerald
No, it's not required to pay the entire amount to get the 5% discount. So, we'll get that discount on any partial payments as well, but obviously, as we indicated, our focus is to pay the full balance.

Ryan Levine
Okay. Then, how does the HFOTCO debt covenants treat the second payment liability [indiscernible] in connection with the acquisition? Would you get any relief in reducing that obligation?

Bob Fitzgerald
No, it has nothing to do with the HFOTCO bank credit facilities and covenants. So, it's clearly separate from that. The HFOTCO debt obviously did not recourse back to SemGroup.

Ryan Levine
Okay. Then, last question, what portion of the full quarterly EBITDA contribution do you expect in the third quarter from Maurepas?

Carlin Conner
So, we're not giving out that level of guidance right now, Ryan, but if you think about what full quarter Maurepas looks like—and we can talk about a $60 million a year run, so that's a quarter is a fourth of that. Then, you can probably back into what it would look like.

Ryan Levine
Okay, that's all from me. Thank you.

CONCLUSION

Carlin Conner
Thank you. Thank you, all, very much for joining us today. We appreciate your continued interest and support. Have a good week.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now--