SemGroup Corporation

Second Quarter 2018 Earnings Call

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CORPORATE PARTICIPANTS

Alisa Perkins - *Head, Investor Relations*

Carlin Conner - *Chief Executive Officer*

Bob Fitzgerald - *Chief Financial Officer*

PRESENTATION

Operator
Good morning, ladies and gentlemen, and welcome to the SemGroup's Second Quarter 2018 Earnings Conference Call. As a reminder, this call is being recorded. All participants will be in a 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 touch-tone phone. To withdraw your question, please press star, 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, Danielle. Good morning everyone. Before we begin, I would like to remind you that our earnings release and presentation for today's call include 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, including reconciliations to GAAP financial measures.

Hosting the call today is Carlin Conner, our CEO, and Bob Fitzgerald, our CFO. With that, let me turn the call over to Carlin.

Carlin Conner
Thank you, Alisa, and good morning everyone. We are pleased to be here today to review SemGroup's financial performance for the second quarter and provide a business update.

We continue to make progress with our strategic transformation and I'm pleased with the results so far. We have streamlined our portfolio and integrated our new terminal on the Houston Ship Channel. From an asset and cash flow perspective, we are a much different company than a year ago. We now enjoy a much stronger downstream-facing position with nearly half of our earnings coming from demand-pull customers.

The increase in more secure commodity-shielded cash flows provides balance to our upstream-facing business. At the same time, we continue to leverage our existing assets with projects like the STACK gas expansion and the announced conversion of one of our White Cliffs pipeline to NGL service.

In the second quarter, Adjusted EBITDA grew 6% over the previous quarter, providing quarterly dividend coverage of 1.4 times. We are on track to finish the year within our guidance range of $385 million to $415 million, up significantly from last year. Importantly, we have increased our take-or-pay cash flow to almost 60% by transforming our portfolio.

From a balance sheet perspective, our most pressing priority is to continue our capital raise initiatives that would allow us to reach our leverage goals. We have raised over $800 million to date and we are pursuing other financial transactions to be announced.

We remain focused on disciplined capex spending. At midpoint 2018 we have spent about 60% of the $350 million we are guiding to for the year. We continue to execute on projects in key regions while optimizing and adapting our assets to serve changing market demands.

On the Gulf Coast, our fifth deepwater ship dock was completed in June, as well as an additional 1.45 million barrels of contracted crude storage, which began generating revenues in the third quarter. HFOTCO continues to position us to serve customers in market segments in many different ways, and to be an active participant in the growing export market.

Projects around our sour gas footprint in Canada are progressing. The Wapiti plant is on track for start-up in early 2019, which we expect to have fully committed by the end of this year. In addition, Smoke Lake will be coming online in late 2019.

In the Mid Continent, we are making progress on the conversion of one of the White Cliffs lines to NGL service. The converted line will move Y grade from the DJ Basin to Cushing, and then on to Mount Belvieu via DCP's Southern Hills Pipeline, and is expected to be in service in fourth quarter 2019.

Overall, during the second quarter we improved results and cash flows. We focused on prudent capital spending and continue to advance financing transactions designed to reduce leverage. All this was achieved while staying extremely proactive on the commercial front, focusing on high-return, strategic opportunities.

For a closer look at our second quarter results, I will hand the call over to Bob.

Bob Fitzgerald

Thank you, Carlin. Yesterday, SemGroup reported a net loss of $2.7 million in the second quarter compared to a net loss of $33 million in the prior quarter. The improvement is primarily due to lower income tax and interest expense pertaining to nonrecurring items recognized during the first quarter.

Second quarter Adjusted EBITDA was $99 million compared to $93.4 million in the first quarter. The 6% increase was due to stronger crude volumes and margin, as well as the absence of a one-time insurance claim write-off recognized during the first quarter.

We declared our quarterly dividend yesterday, and as Carlin noted, our coverage is 1.4 times.

We ended the quarter with a total consolidated net leverage ratio of 5.6 times and consolidate available liquidity of nearly $652 million. Our consolidated leverage increased quarter-over-quarter, resulting from the final HFOTCO acquisition payment in April and our ongoing growth projects in the Gulf Coast and Canada. With our current plan, we believe we can achieve our leverage target of 5 times by the end of 2019 without the issuance of common equity.

During June, we successfully refinanced HFOTCO's Term Loan B which lowered the interest rate margin by 75 basis points and extended maturity to 2025. Concurrent with this refinancing, we repaid and terminated HFOTCO's revolving credit facility. HFOTCO's current debt is now covenant-light and remains independent of SemGroup's corporate credit facility.

Turning to segment profits, second quarter results improved over first quarter in all but one of our operating business units. Crude transportation second quarter segment profits was $38 million compared to $34 million during the previous quarter. The increase was driven primarily by higher White Cliffs Pipeline volumes which averaged 135,000 barrels per day for the quarter, reflecting the success of our incented rate structure to attract uncommitted barrels in the basin. During the second quarter, we were able to capture additional uncommitted barrels that we don't expect to retain in the third quarter as they have migrated to the LLS markets.

Crude facilities reported second quarter profit of $10 million, a slight increase from last quarter, as storage and throughput volumes remained relatively flat with the first quarter.

Crude supply and logistics recorded a $4 million improvement from first quarter's $6 million loss due to improved basis differentials. Looking forward, we expect continued market volatility in the near term and maintain our initial guidance of negative $10 million to negative $15 million segment profits for the full year.

HFOTCO posted second quarter profits of $35 million, essentially the same as the first quarter profit when adjusting for the $4 million write-off of an insurance claim. We expect HFOTCO to increase in the third quarter as Ship Dock 5 and the related crude storage facility begin contributing cash flow.

Turning to SemGas, second quarter segment profit was over $15 million. The increase over the previous quarter was due primarily to higher STACK volumes. Keep in mind STACK volumes are at a lower overall margin when compared to Mississippi Lime contracts which include a gathering fee in addition to the processing fee.

SemCAMS' results were flat as lower processing revenue from the KA plant planned turnaround was offset by higher cost recoveries and favorable timing issues. The plant was down for 31 days during the quarter and has been back and running since June.

Corporate and Other was down due to the absence of some logistics and some Mexico earnings as these businesses were previously sold.

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

Carlin Conner
Thanks, Bob. I'd like to close by thanking our employees for their steadfast execution against our well-defined strategy. Our commitment to our goals has never wavered, even if it meant adapting tactics to changing market conditions. We've powered through and have repositioned the company while reducing risk, growing absolute cash flows and gaining a foothold on the Gulf Coast.

For the back half of 2018 we are focused on four priorities: executing projects on time and on budget; delivering strong financial results; achieving our balance sheet goals while executing on low-multiple growth in and around our footprint. Above all, and as always, we commit to our core value of operating and growing our business in a safe and responsible manner.

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

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 touch-tone phone. If you are using a speaker phone, please pick up your handset before pressing the keys. If at any time your question has been addressed and you would like to withdraw your question, please press star, then two. At this time we will pause momentarily to assemble the roster.

The first question comes from Elvira Scotto of RBC Capital Markets. Please go ahead.

Elvira Scotto
Hey, good morning everyone. Can you give us an update on the White Cliffs, the NGL line conversion? Any additional interest from third parties? Also, any concerns around Initiative 97 potentially being on the ballot in Colorado?

Carlin Conner
Hello, Elvira. This is Carlin. Let me take the first part and then I'll hit the Initiative 97 question.

On the open season, we accomplished what we had hoped to accomplish in conducting the open season. We went out and by having the open season we discovered barrels that needed to flow and we now have a lot of those barrels either committed to our marketing partner, our partner in the pipeline, or potentially will be shipping on their own. We feel like the open season was successful.

The feeling we have at this point in time, and I think our partner expressed this yesterday as well in their call, is that the original economics of the project we definitely will be exceeding those going forward.

As far as Initiative 97, clearly that is a major issue for our Colorado customers, and ultimately the midstream space. We think of this issue as something that is ongoing. There's still a lot to be determined. I think at this point in time we do anticipate that the signatures will be ratified so that the initiative will hit the ballot.

Having said that, we also recognize that the oil and gas industry in Colorado is massive and upwards of $20 billion to $30 billion of GDP is generated per year by the oil and gas industry. I think I read over 200,000 jobs are impacted potentially by this initiative—or are generated by the oil and gas industry with the large majority would be potentially at risk if this initiative passed.

We're paying very close attention to this. I think it's going to be a story that's going to kind of unwind itself over the next couple of months but it's something to pay attention to.

Elvira Scotto
Thanks for that. Moving over to supply and logistics, I know you haven't changed the 2018 guidance but shouldn't Supply and Logistics benefit from some of these, the various differentials? Then maybe can you talk about how Supply and Logistics can work with HFOTCO to maybe capture incremental margins?

Carlin Conner
Let me take the HFOTCO piece and then I'll let Bob answer the first part of the S&L question which is more about the Mid-Con.

We definitely believe that HFOTCO is an asset with a strong strategy around Gulf Coast, having that position should provide opportunities for us to as they say nibble around the edges and make some money around that asset, optimize that asset. When we bought HFOTCO we had considered that there would be potentially some Corporate earnings that would fall in the S&L bucket that would be generated by the ownership of that asset. We're still working through that. We really haven't seen any of that yet. We're getting our strategy in place, and also the staff needed to execute around the asset.

Bob, you want to answer the Mid-Con question?

Bob Fitzgerald
Sure. If you think about 2018, Elvira, and what we're looking at from the second quarter reading through to the second half, the second quarter benefited from stronger blending margins which are largely going to be related to quality and crude differential in markets that feed into Cushing where we do all our blending. It's a fairly limited footprint and it's really driven by what those differentials look like coming in to Cushing.

We also had benefited from a widening location spread relative to North Dakota, and that helped us to recover some of our take-or-pay commitments we've had on DAPL. We see that still contracting a little bit this year, so that's why we reaffirmed our guidance. We don't see it really blowing out beyond that. We think we're still well within our range.

Elvira Scotto
Helpful. Thank you. Then just the last one from me for now, can you talk about the dynamics around Cushing storage? Any updated thoughts giving backwardation and your contracts rolling off next year? Maybe remind us what percent of the capacity is contracted by customers that use that storage for operational purposes versus contango trades?

Carlin Conner
Yes. This is Carlin. Clearly the market is softening a little bit in Cushing and as we are moving into renewal discussions we see a little bit of softness relative to our $0.33 per barrel average. However, we are being a little more creative on the re-leasing of those assets and at these maybe lower numbers and trying to create mechanisms for us to capture some upside as the market returns.

We do believe that at some point contango will slip back in and that storage will be valued, but in the meantime, as we recontract, we are thinking about tenure and ways to mitigate downside pricing that we put on the tankage today.

We feel pretty comfortable with where we are. There's quite a bit of tankage, as you know, that is coming on and off, and we'll continue to execute on the recontracting.

Elvira Scotto
Sorry, just to follow-up on that, so the rates that you're seeing now versus the $0.33, I mean are we talking mid to high $0.20s?

Carlin Conner
We're in the middle of negotiating so we really want to share too much. I think I would like to kind of leave it at it's less than our average $0.33 rate.

Elvira Scotto
Okay, great. Thanks a lot.

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

Bronson Fleig
Hey guys, this is actually Bronson Fleig filling in for Tristan. Looking at the leverage outlook and

the target of 5 times by the year-end 2019, just curious on the assumptions for projects addbacks there. The disclosure you offered was helpful on the $50 million in project addbacks for the quarter. Should we expect that addback number to increase in 2019 as you approach completion of many of these large projects that are yet to be contributing?

Bob Fitzgerald
Bronson, this is Bob. I'll take that. As we see these projects—I think you're referring to the material project adjustments that we outlined …

Bronson Fleig
Yes, sir.

Bob Fitzgerald
Once those projects come online that addback will get reduced and our actuals start flowing through there. We will go ahead and lower what those project addbacks are for any specific project as we start seeing and realizing the actual EBITDA coming onboard. As new projects come on there's a possibility that that can continue to evolve over time. We effectively just follow the same methodology that we employ in the senior secured credit facility at SemGroup in terms of material project addbacks.

Bronson Fleig
Okay, great. That's very helpful. Then one last for us on SemCAMS just acknowledging the quarter was impacted by the KA plant turnaround. We were wondering if you guys could just touch on that outlook for the balance of the year and if initial 2018 volume guide is still relatively intact following the quarter?

Bob Fitzgerald
This is Bob again. Yes, we still feel pretty confident about our volumes coming through. As I mentioned earlier, the plant was down during pretty much the month of May. It's been up and running since early June, so everything is working as we expected today. The planned down turnaround was factored into our guidance.

We look at steady flows going through this year, obviously until we see the big step-up which will happen early 2019 when we bring on Wapiti. Then, as Carlin noted in his comments, at the end of '19 we'll also have the benefit of Smoke Lake, so '19 will be a pretty big step-up year for us.

Bronson Fleig
Okay, great. Thanks guys.

Operator
The next question comes from Justin Jenkins of Raymond James. Please go ahead.

Justin Jenkins
Great, thanks. Good morning everybody. I guess if I could start on the guidance front, Carlin, could you maybe frame the different aspects of the forecast that might push us toward the high end or the low end of the 2018 guide?

Carlin Conner
Yes. We reaffirmed therefore we still believe our forecast is right around that midpoint. The things that we are paying attention to obviously are White Cliffs volumes going forward. As we

mentioned, we had a really strong second quarter that we do not believe we will repeat, therefore we need to make sure we understand that. We still believe we're going to handle more barrels on White Cliffs than take-or-pays, but there's some room there to flex one way or the other.

Then I think S&L, S&L has always been the most difficult portion of our portfolio to tag, mainly because the market gives us what we can do there, and as differentials move around we hope to continue to maybe beat our forecast, so there could be some upside, but at the same time we could see differentials going the other direction that could create more tension to the downside.

We felt it was comfortable for us to kind of keep the range where it is at this point in time. We'll learn more obviously in the third quarter.

Justin Jenkins
Perfect. Thanks for that. Then I guess moving on to the new project set, how should we think about the EBITDA ramp from a timeframe perspective with the new HFOTCO assets in service, and also maybe the same question for the Wapiti plant in early '19?

Carlin Conner
The HFOTCO crude expansion, it is now in earnings service, right? We're going to see the impact of that in the third and fourth quarter. The Wapiti plant, that's a 2019 event, so it will not impact us at all. From a capex spend we're right on target; $350 million is our guide for capex in '18 and with both of those projects ongoing, one being essentially complete and the other still ongoing, we still are forecasting that we'll hit that number on the capital side.

Justin Jenkins
Perfect. Thanks, Carlin. I'll leave it there.

Operator
This concludes our question and answer session. I would now like to turn the conference back over to Carlin Conner for closing remarks.

CONCLUSION

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

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