Specifics murky on SemGroup tumble

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Speculation focuses on what happened at the dynamic company that's now mulling bankruptcy.

SemGroup LP, which announced Thursday it is considering bankruptcy, grew at a stunning pace since its inception in 2000.

Now it needs to move rapidly to address its financial issues.

"I think it's an even bet whether they will file for bankruptcy," Kevin Starke, a credit analyst at CRT Capital Group in Stamford, Conn., said in a telephone interview. "I also wouldn't be surprised if they got rescue financing, but they have to do it quick."

SemGroup was co-founded by Thomas Kivisto, who was replaced as president and CEO on Friday by Senior Vice President Terry Ronan.

Kivisto began putting together SemGroup just as Enron Corp. was having problems and the rest of the energy sector was feeling the aftershocks.

Still, it didn't take long for Kivisto to secure start-up funding and launch the new enterprise. In its first five years alone, SemGroup made more than 20 acquisitions, enhancing its core business of gathering, transporting, storing and marketing crude oil, natural gas and refined petroleum products.

It became recognized by Forbes magazine as one of the largest privately held U.S. companies.

But SemGroup was far from satisfied with its early success.

"Our mission is to keep growing and be here in Tulsa," Kivisto told the Tulsa World in 2005.

That expansion continued unabated. SemGroup grew its space in several buildings southwest of 61st Street and Yale Avenue, and built a lab and testing area for its asphalt unit.

The company became a cutting-edge player in the road business, marketing an asphalt design filled with tiny holes that drained water from the surface.

By last summer, SemGroup had bought more than 50 companies. It also launched a publicly traded entity, SemGroup Energy Partners LP.

So what happened? That's been the question asked all over Tulsa the past few days as the stock of the parent company's public subsidiary, SemGroup Energy Partners LP, plummeted from more than $22 a share at Thursday's opening on the Nasdaq to $8.30 at Friday's close.

The company, so far, has only referenced "liquidity issues." No one knows the specifics, so at this point there only is some data to look at from Moody's Investor Service — and a lot of theories and speculation.

Starke, the credit analyst, pointed to several factors cited by Moody's on Thursday when the firm downgraded SemGroup's debt rating.

One was SemGroup's heavy acquisition program and capital spending, Starke said. Another was the liquidity requirements of its hedging program.

The hedging program possibly is the most difficult for people outside the industry to understand, he noted.

"The simple way to explain it is that the company would take a lot of oil from independent producers and deliver it by pipeline, truck or other means to a central exchange — such as the facilities in Cushing — or directly to other users or refiners," Starke explained.

There can be a time lag as the fuel is transported and also as it is stored, he said. "You don't necessarily come up with a buyer for every seller right away."

SemGroup could use hedging, or futures contracts, to lock in a specific oil price for a specific time period. Such a strategy is designed to protect the company from significant price swings in the commodities it markets.

With oil prices soaring in the second quarter, any bet that prices would drop would create a problem, he said. The analyst walked through a hypothetical scenario:

"If you hedge 13 million barrels of oil, that is a $1.65 billion position. You need to put up 30 percent of that on your account. If the price of oil goes up, though, you would need to add more money to your account to cover the increased margin."

At the end of the first quarter, SemGroup's cash position was $140 million, Starke said, citing Moody's data. If it had to buy 13 million barrels of oil in mid-July at $138 a barrel after entering into a future delivery contract in late March at $101, that would have eaten up all of SemGroup's cash, he said.

"So, this all could happen without any wrongdoing by anyone. There may not have been any wild bets on the price of oil. It could just be the demand for the additional margin," he said.

Another possibility, according to Fred Russell, CEO of Fredric E. Russell Investment Management in Tulsa, is that SemGroup could have chosen to go "naked," or to buy and sell without hedging, during the past few months.

"You could think, 'Oil is at an absurd price now.' Someone could have guessed wrong — that oil would go down — and then, lo and behold, you have to deliver oil that now costs you $140 a barrel instead of $100."

In other words, the company could have had a futures contract to sell a certain amount of oil on a certain date, without its own complimentary hedge, and found itself "naked" or having to acquire the oil to deliver at the current market price.

Starke said his reading of Moody's data would indicate there were protections written into the company's credit agreements to prevent the naked situation.

"That would have been a violation of the bank covenant," Starke said.

What actually happened likely will be disclosed as the company works its way out of the crisis.

Until then, local business leaders are showing their support for SemGroup, which employs 400 in Tulsa and 2,000 worldwide.

"SemGroup has been an extremely good corporate citizen," said Mike Neal, CEO of the Tulsa Metro Chamber, in an interview. "They have been a strong financial supporter to all facets of the community and both management and employees have been actively engaged."

"We're not sure what the next step is, but we want SemGroup to know there will be strong local support for the company."

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