



Sandridge Energy

Relative Value

As a single-asset company with modest economics, SandRidge (SD) is relatively more vulnerable to the new, significantly weaker commodity price landscape. Notwithstanding the high-grading and the substantial operational improvements across its Mississippian acreage over the past two years, the company is likely to struggle to build a sustainable business over the long term given the weak outlook for oil prices. DB equity research sees the Mississippian Lime achieving a 10% IRR at \$80/bbl oil, one of the most challenged plays in the US. The structural funding gap problem – the intensity of which had been steadily receding in recent quarters due to solid operational performance – is now front and center. Despite a sharp ramp down in its capital program – we expect annual capex to average \$1 billion over the next two years (versus \$1.6 billion in FY 14E) – we see the company burning \$1.2 billion of cash through FY 16, exhausting most of its current liquidity of \$1.3 billion. More worryingly, we see outlook for continued cash burn indefinitely beyond FY 16 even in a maintenance capex mode. We see annual run-rate EBITDA of ~\$710 million at \$65 oil/\$3.75 gas. Given annual interest obligation of close to \$300 million, the company will clearly be unable to meet maintenance capex of, say, \$500-700 million and remain FCF neutral. This situation would be further aggravated in a downside scenario of \$60 oil/\$3.5 gas with EBITDA dropping to \$560 million. In short, the Mississippian acreage is not well suited for a low commodity price environment, especially as a core play for a company as financially leveraged like SD. Further, the option of augmenting its liquidity via asset divestitures, which appeared to be a viable one just a few months back, is now all but gone. Its midstream infrastructure in the Mississippian play, which might have fetched a valuation of up to \$1 billion earlier will now be worth much less, and on a partial monetization, could receive maybe \$200-\$250 million. This overlooks the difficulty in even attracting buyers given questions over long term sustainability of play economics. The value of its stake in upstream trust subsidiaries has also taken a severe beating in recent months and is now worth a little over \$100 million.

While we acknowledge that the recent resolution to the financial filings is a positive, the viability of the Mississippian play is still a major concern for the market as evidenced by the trading levels of other HY issuers with core positions in that play. Midstates Petroleum (MPO, not covered) is a relatively smaller Mississippian comp with a fraction of the liquidity of SD and about 1.5x turns more leverage (6.5x in 2016 Bloomberg consensus) – it trades at about 2x the spread of SD (STW: ~2500 bps area). That said, looking at SandRidge, we don't see any visible catalysts on the horizon. Technically speaking, the credit is up roughly 10 points from its mid-December lows (bonds now in the 66-67 area, YTW: 15-18%) leaving us to believe that upside/downside is skewed to the downside as we enter the seasonally weak 1H. Further, we think current trading levels already have an expectation of lower announced 2015 capex levels built in. With that said, we are moving to a SELL from a HOLD rating on the name as we believe one could see more attractive entry points in the name going forward. Upside includes better well cost reductions and higher type curves and lower than expected FCF burn.