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Midstates Proposes Merger With Rival Sandridge

Midstates Petroleum is making an all-stock offer to its chief US Midcontinent rival Sandridge Energy in what could create a leading E&P company in the Mississippian Lime play.

And the companies, which both emerged from bankruptcy in October 2016, share more than a home in Oklahoma. Activist hedge fund Fir Tree Partners is a major shareholder in each.

In fact, Midstates' suggestion of teaming with Sandridge comes about six weeks after Sandridge buckled beneath investor pressure — led by Fir Tree and billionaire activist investor Carl Icahn — to quash its proposed $746 million merger with Bonanza Creek Energy (OD Dec.29'17).

Fir Tree controls a combined 40% stake in Midstates with Avenue Capital Group, a separate hedge fund that also supports Midstates' bid. Roughly 40% of Midstates' and Sandridge's shareholders overlap, according to Midstates.

Icahn was unavailable to comment, and Fir Tree declined to do so. Sandridge didn't respond to a request from Oil Daily.

It's likely that Icahn is aware of, and supports, Midstates' offer, said Christopher Hewitt, a corporate lawyer in the Cleveland office of Tucker Ellis who advises companies on takeover preparedness and defense.

What's more, he told OD, the proposal might have been in the works during the Bonanza Creek showdown.

Key Midstates investor Avenue Capital converted its intent registered with the US Securities & Exchange Commission from passive to active on Nov. 14. The firm also suggested that Midstates hire an adviser to weigh strategic alternatives. Meanwhile, Sandridge announced its plan to buy Bonanza Creek on Nov. 17.

Midstates is offering 1.068 shares for each Sandridge share. Sandridge investors would own 60% of the combined company, but Midstates management would run the enterprise. It would effectively be a reverse takeover.

"The role of overlapping large holders in both entities suggests this is an effort to put Sandridge's assets into Midstates' hands, which implies Sandridge's management and board would be unlikely to survive the merger," said Mizuho analyst Timothy Rezvan.

Icahn has taken particular issue with CEO James Bennett, the finance chief that presided over the 2013 ouster of former CEO Tom Ward and his $90 million severance deal. Once Ward was out, Bennett was named chief executive.

Icahn has also called for an overhaul of membership on the board of directors and a weakening of its "poison pill," a mechanism generally used to ward off takeover threats (OD Nov.28'17). Sandridge has capitulated, to some extent, on Icahn's demands — with the exception of a board shake-up (OD Dec.1'17).

But it may not be enough.

Midstates' letter emphasizes the board's "strong preference to execute this transaction on a negotiated basis." Hewitt notes that a non-negotiated basis is an unsolicited or hostile offer.

"A classic hostile strategy is to launch a proxy contest and a hostile tender offer at the same time. The proxy contest replaces the board to dismantle any defenses — including the pill — and then accept the exchange offer or recommend to shareholders that they accept the exchange offer," he said. "There is a veiled threat to go hostile if Sandridge doesn't engage."

The combined company would have "zero net debt, strong liquidity, and forecasted free cash flow generation of up to $480 million over the next five years," Midstates' president and CEO David Sambrooks said. "The strategic fit and geographic overlap of both companies' assets in the [Mississippian] Lime and [northwestern] Stack builds critical mass, creates significant synergies, and generates superior, risk-adjusted returns."

The new entity would have a market cap near $977 million, but the quality of the assets remains a concern, even with promises of free cash flow, Rezvan said.

Deon Daugherty, Houston

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