Diamondback Energy Inc. (FANG)

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DIAMONDBACK
ENERGY

I. Investment Overview

Previous Thesis (Fall 2021)

Hold FANG at 1.79% allocation

1	**Sustained FCF Growth**	• Have increased FCF each of the last 3 quarters; largest amount of FCF generated ever last quarter ($740 million) • Returning money to shareholders through share buybacks and increased dividend • Dividend has increased each of the last 3 quarters
2	**Break-even price**	• Returning money to shareholders through share buybacks and increased dividend • Dividend has increased each of the last 3 quarters
3	**Low production costs**	• Plan to keep production flat for 2022 while still increasing money returned to investors • Continue to decrease operating costs through optimization if they do increase pumping at some point
4	**Completed Acquisitions**	• Acquired Guidon and QEP in the Midland Basin • Increases exposure in largest oil producing area in the U.S.

Investment Thesis

Trim FANG to Standard Allocation

1	**Lack of Diversification**	• Permian Basin works well but Diamondback is not diversifying outside of the area • **Lack of aggressive M&A** since QEP acquisition • Other oil majors exploring alternative options
2	**Limited Production Growth and Well Expansion**	• No plans to increase current **production** • Plan to continue to drill, but staying committed to Permian area and limited outside exploration or drilling
3	**Sustained FCF and Healthy Margins**	• $772 million in **FCF** for Q4 2021; $2.42 billion for 2021 • **Dividend** increase: $2.40 per share annual dividend, up ~20% from $2.00 per share previously and up 50% year over year • Q4 2021: repurchased almost 4 million shares for around $410 million
4	**Short-term uncertainty in Energy markets**	• Short and medium-term concerns for oil with continuing effects of global energy crisis and Russo-Ukrainian war • Unwillingness to invest in oil production capacity and exploration as investors and corporations increase renewable investments
5	**Cashing out on current returns**	• We bought FANG at $73.79 about 2 years ago, currently at $138.10 (+87.15%) • Target: 1.36% of portfolio, but currently at 2.11% of portfolio • Trimming would still give us position for continued gains but allow us to invest in other equities and protect against uncertainty while oil is high

Company Overview

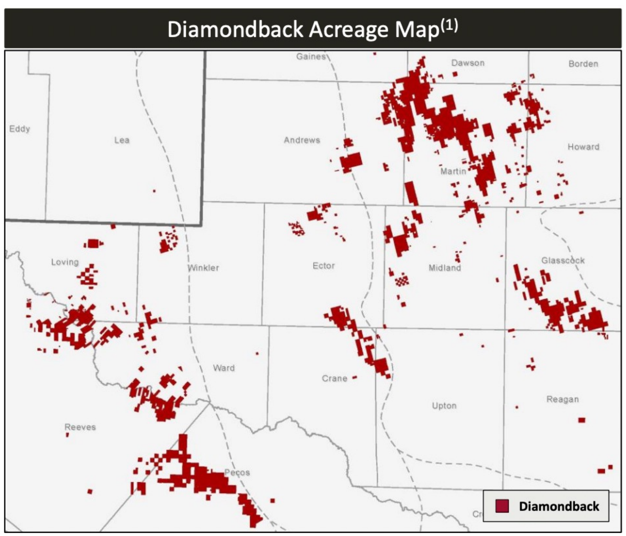
Business Description

- Diamondback is an independent oil and natural gas company headquartered in Midland, Texas
- Focused on the acquisition, development, exploration & exploitation of oil & natural gas in the Permian Basin
- Operates in 414,000 acres (see map below)
- Average production of 226.3 MBO/d (387.1 MBOE/d)
- Continued focus on dominance in the Midland and Delaware Basin

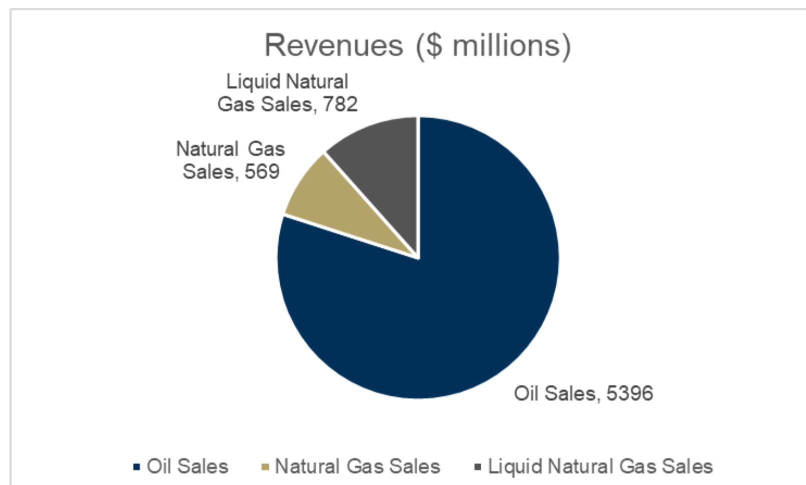
Key Statistics

GICS Sub-Industry	Oil & Gas Exploration & Production
Market Cap	$23.2B
Revenue	$5.97B
Current Price	$138.10
52-Week Range	$65.93 / $138.47
Beta	2.35
Dividend Yield	1.80%
Credit Rating	BBB-

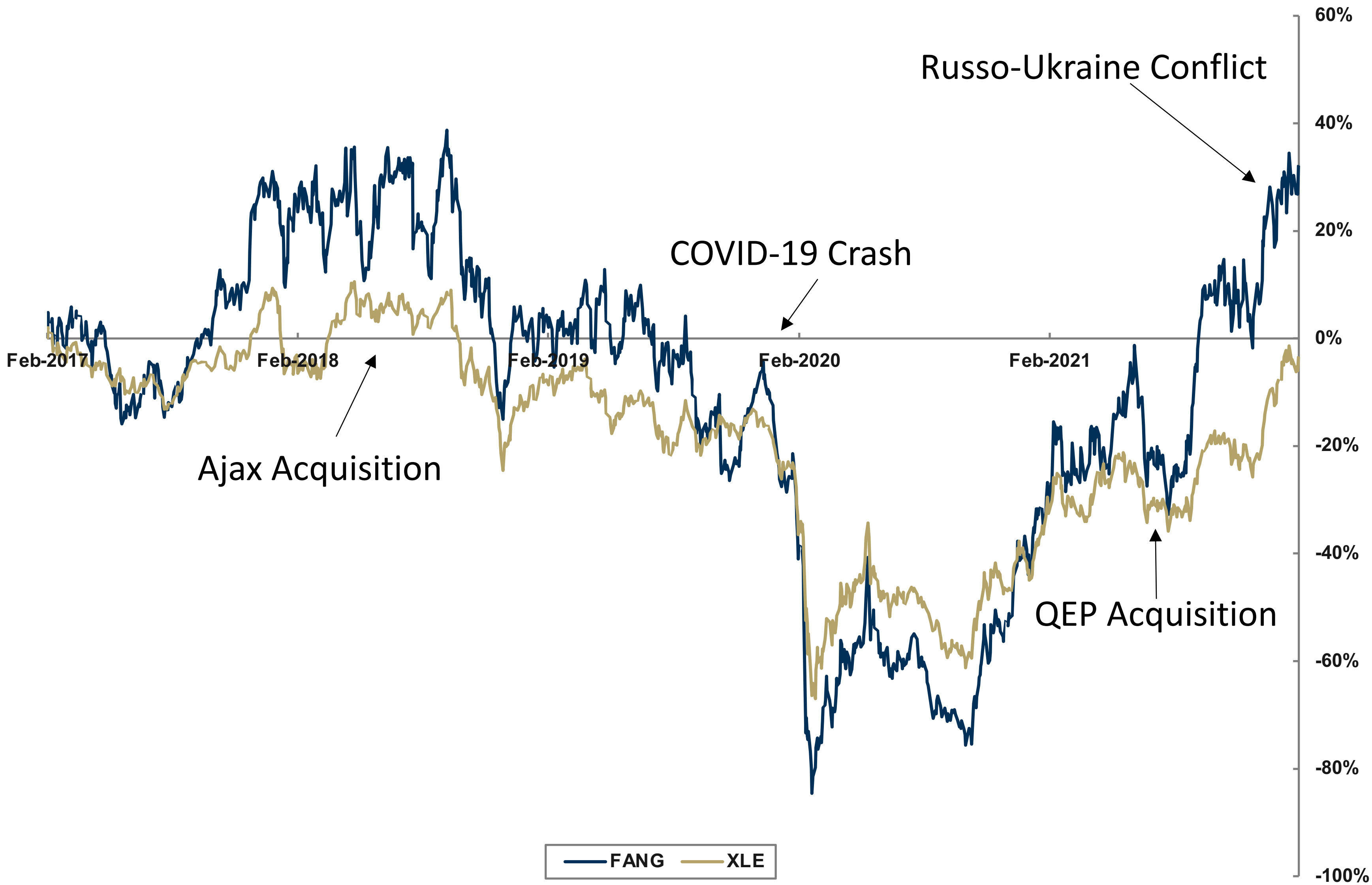
Diamondback Acreage Map



Segment Breakdown



5-Year Performance



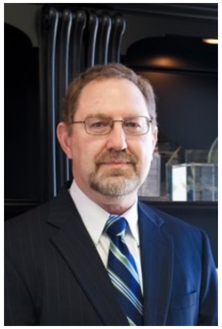
Management Bios

Travis D. Stice – CEO & Director

- He has served as CEO since 2012, after a brief stint as COO
- Almost 40 years in oil and gas experience, and almost 30 years of management experience
- Owns over $50M of Diamondback shares

Kaes Van't Hof – CFO & EVP of Business Development

- Joined Diamondback in 2016, served as CFO since 2019
- Previous roles include VP at Diamondback , CEO of Bison Drilling & Field Services, an Investment Banker at Citigroup, and an Analyst at Wexford Capital that helped IPO Diamondback
- Owns over $7.7M of Diamondback shares



Russell D. Pantermuehl – EVP & Chief Engineer

- He has served as Chief Engineer since 2019, been with Diamondback since 2011
- Worked in oil & gas industry since 2000
- Owns over $16.1M of Diamondback shares

Diamondback has highly qualified executives with decades of industry and management experience

There is significant stock ownership amongst executives

II. Business Segments

Segment Overview

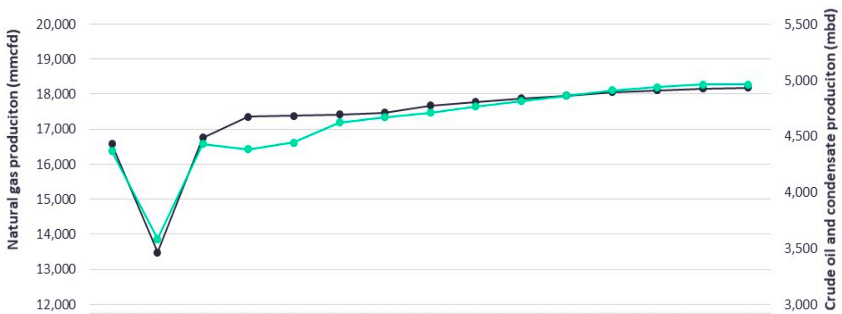
Permian Basin

- Oil production in Permian Basin set record in December averaging **4.92M bbl/day** and is forecasted to exceed 5M bbl/day for the first time in February
- Permian Basin production has recovered faster than other areas in the U.S due to **low production costs** that make it appealing to drillers
- FANG along with four of the other largest shale drillers all have about a decade or more of profitable well sites at their current drilling pace but would exhaust that inventory within about **six years if they raised production 15%/year**, according to the analysis.

Oil Macro Trends

- Energy Information Administration (EIA) expects U.S. production to grow about **5.4% through the end of 2022**
- PXD, DVN, and CLR reported highest annual profits in over a decade but are pledging austerity despite a tightening oil-market supply, keeping oil low in an agreement with Wall Street.
- Brent Crude oil touched a seven-year high of more than $99 (£73) a barrel after Ukraine invasion
- Biden is urging U.S. based companies and OPEC to ramp up production to lower gas prices
- US and allies will release **60 million barrels** from reserves to lower price

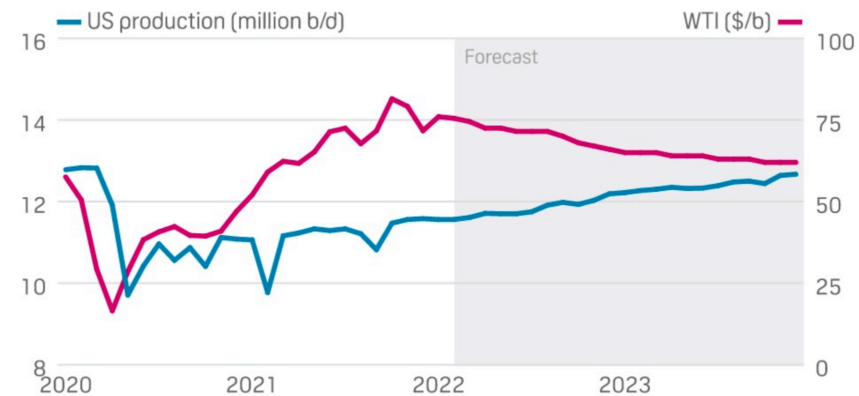
Permian Basin, Monthly Production Outlook till March 2022



	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22
Natural gas (mmcfd)	16,559	13,483	16,751	17,353	17,384	17,421	17,464	17,660	17,771	17,862	17,953	18,045	18,111	18,158	18,174
Crude oil and condensate (mbd)	4,362	3,583	4,432	4,381	4,443	4,616	4,666	4,707	4,761	4,810	4,858	4,904	4,935	4,958	4,964

Natural gas (mmcfd) Crude oil and condensate (mbd)

EIA PREDICTS US OIL OUTPUT RECOVERY BY 2023



Source: US Energy Information Administration

Recent News

Earnings Report

- Beat 4th Quarter Earnings Forecast by **7.4%**
- Net debt decrease and FCF increase
- Pledged to return **50% of FCF** to Investors
- Proved reserves F&D costs have dropped to $7.87 and general efficiency continues to improve, lowering margins
- No growth outside Permian Basin, while reserves and production continue to be limited

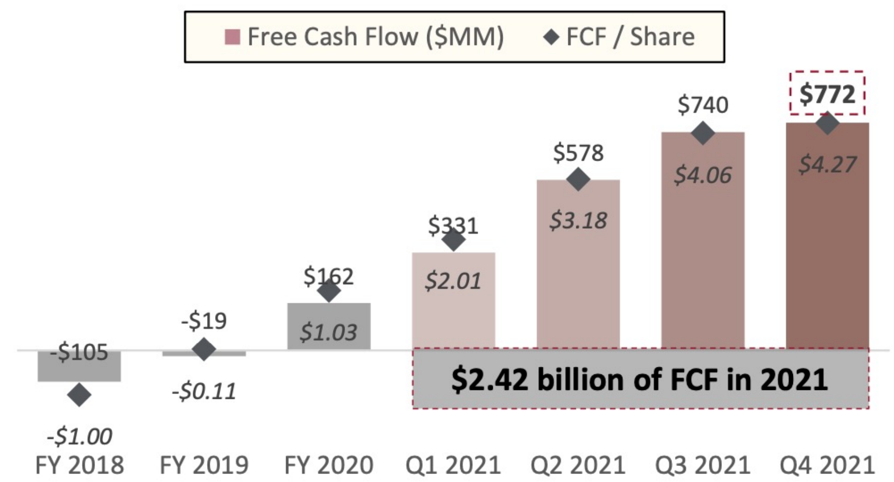
2022 Guidance

- Increasing annual dividend by **20% to $2.40 per share**
- Oil production guidance of **218 - 222 MBO/d**
- CAPEX guidance of **$1.75 - $1.90 billion**
- **$5.8 billion of net cash** provided by operating activities
- **$4.0 billion of Free Cash Flow**
- FANG expects to drill between **270 and 290 gross (248 – 267 net) wells** and complete between 260 and 280 gross (240 – 258 net) wells with an average lateral length of approximately 10,200 feet

Viper & Rattler Subsidiaries

- Viper - mineral & royalty interest subsidiary with primarily undeveloped assets
- 27,027 net royalty acres, ~54% of which are operated by Diamondback
- Rattler - Midstream subsidiary which provides infrastructure & services to FANG & other operators per long-term, take or pay contracts
- Acquired certain water midstream assets from Diamondback for $160 million in cash

Consolidated Free Cash Flow Generation[1]



III. Valuation

Relative Valuation

Company	Market Cap	Forward EV/EBITDA	Debt/EBITDA	Forward PE	Netback/BOE	Operating Margin	Dividend Yield
Diamondback	$23.66B	6.77x	1.49x	7.33x	$47.54	48.13%	1.80%
Chevron	$273.40B	7.43x	0.86x	13.28x	$64.58	10.19%	4.05%
Pioneer	$55.69B	10.93x	0.63x	10.84x	$49.56	23.57%	2.41%
Occidental	$36.19B	7.55x	2.16x	10.41x	$32.17	16.80%	1.34%
ConocoPhillips	$118.61B	6.26x	0.79x	10.46x	$88.53	27.43%	1.56%
Median	$55.69B	7.43x	0.86x	10.41x	$49.56	23.57%	1.80%

Positives

- **Operating Margin** - Leading margin compared to rest of Permian Basin comps, indicating efficiency within the business model and low operating costs
- **Dividend Yield –** Sustained strong dividend yield with minimal risk and consistency

Negatives

- **Debt/EBITDA** - More leveraged than some others as a result of F&D, however this number continues to decrease
- **Forward PE** - Despite earnings being expected to increase, the low forward PE indicates less prospective growth

Discounted Cash Flow Model

Implied Upside of 10% remaining

		Exit Multiple				
		6.4x	6.9x	7.4x	7.9x	8.4x
	7.85%	$137.03	$147.68	$158.34	$169.00	$179.66
	8.35%	$133.49	$143.90	$154.31	$164.73	$175.14
WACC	8.85%	$130.04	$140.22	**$150.39**	$160.57	$170.75
	9.35%	$126.69	$136.63	$146.58	$156.52	$166.47
	9.85%	$123.42	$133.14	$142.86	$152.58	$162.31

Model Assumptions

- Sustained FCF growth lower than preceding high production years.
- Consistent margin growth due to high operating efficiency.
- Conservative revenue growth as F&D decreases

WACC Calculation

Assumptions	
Tax Rate	22%
Exit Multiple (EBITDA)	7.4x
WACC Calculation	
Risk Free Rate	1.97%
Beta	1.53
Market Risk Premium	5.70%
Cost of Equity	10.7%
Pre-Tax Cost of Debt	2.98%
Market Cap	$ 23,644
BV of Debt	$ 6,687
Equity-to-Value	78.0%
Debt-to-Value	22.0%
WACC	**8.85%**

Oil Metrics

O&G Ratios		FY19	FY20	FY21
Reserve Life				
	Years	**10.94**	**11.96**	**13.05**
Production Replacement (&)				
	All sources	231.07%	271.82%	444.53%
	Organic only (excluding purchases & sales)	250.49%	269.09%	280.29%
	Organic only (excluding purchases & sales) - 3 year			**268.00%**
Finding & Development (F&D) costs per BOE				
	All sources	$ 14.63	$ 5.34	$ 10.46
	Organic only (excluding purchases & sales)	$ 11.13	$ 5.00	$ 4.53
	Organic only (excluding purchases & sales) - 3 year			**$ 6.49**
Recycle Ratio				
	Netback/F&D per BOE	**2.06**	**3.47**	**3.90**

E&P Analysis

Netback Calculations	FY19	FY20	FY21
Operating netback	$ 30.22	$ 18.53	$ 40.77
Cash flow netback	$ 27.82	$ 16.76	$ 37.67
Full-Cycle Cash Margin			
Revenues less operating expenses, non-income tax	$ 30.22	$ 18.53	$ 40.77
F&D	$ 11.13	$ 5.00	$ 4.53
Netback less F&D	**$ 19.09**	**$ 13.53**	**$ 36.24**

Analysis

- **Reserve Life –** Increasing with exploration/development but could see sharp decline in reserves in coming years
- **Production Replacement** – Large metric indicates company has room for growth
- **F&D Costs** – Very low due to no exploration beyond Permian Basin
- **Recycle Ratio –** Big drop in growth from 2020 to 2021
- **Operating Netback** – Good efficiency when market prices are high

IV. Conclusion

Investment Risks

		Risks	Mitigations
1	**Lack of Geographic Expansion**	• Diamondback staying committed to Midland and Delaware Basins – the Permian Basin • Not committed to expanding outside of that area	• Permian Basin is a renowned source of oil reserves with record breaking production • 40 years of life remaining
2	**Uncertainty in Energy Markets**	• Oil prices face grave uncertainty from a global energy crisis and the Russo-Ukranian War • Oil demand	• Other countries making the shift to clean energy too fast are facing intermittency problems • Uncertainty in Russo-Ukraine has caused increase in oil
3	**Lifetime Reserves**	• About a decade of reserves left, but it would be 6 years if production raised by 15% a year • Oil majors in Permian are increasing their production (eg. Chevron, Exxon)	• Continuing flat Permian basin production • Not committed to increase production to maintain reserve lifetime
4	**Shift to LNG and Renewables**	• Shift to greener, cleaner energy • LNG investment as worthwhile, cleaner than oil during renewable transition	• Lack of easily available utility storage for large scale intermittent renewable adoption • Still large demand for oil during transition

Summary

Sustained FCF and Healthy Margins

- $772 million in FCF for Q4 2021; $2.42 billion for 2021
- Dividend increase: $2.40 per share annual dividend, up ~20% from $2.00 per share previously and up 50% year over year
- Q4 2021: repurchased almost 4 million shares for around $410 million

Uncertainty in Growth Potential

- Lack of geographic expansion out of the Permian Basin and slowed acquisition growth
- Global energy crisis and Russo-Ukrainian Conflict have unprecedented uncertainties for the energy market
- Adoption of LNG and renewables

Cashing out on returns

- We bought at $73.79 2 years ago, currently at $138.10 (+87.15%)
- Target: 1.36% of portfolio, but currently at 2.11% of portfolio
- Trimming would still give us position for continued gains but allow us to invest in other equities and protect against uncertainty while oil is high

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V. Appendix

Discounted Cash Flow

	Historical 2017	Historical 2018	Historical 2019	Expected 2020	Projected 2021	Projected 2022	Projected 2023	Projected 2024	Projected 2025
Revenue	$ 4,031	$ 3,056	$ 5,567	$ 7,348	$ 6,932	$ 7,504	$ 8,179	$ 8,977	$ 9,919
% YoY Growth	*N/A*	*-24.19%*	*82.17%*	*31.99%*	*7.50%*	*8.25%*	*9.00%*	*9.75%*	*10.50%*
Cost of Goods Sold	$ 833	$ 767	$ 1,202	$ 1,400	$ 1,386	$ 1,486	$ 1,603	$ 1,741	$ 1,905
Gross Profit	$ 3,198	$ 2,289	$ 4,365	$ 5,948	$ 5,546	$ 6,018	$ 6,576	$ 7,235	$ 8,015
% Margin	*79.34%*	*74.90%*	*78.41%*	*80.95%*	*80.00%*	*80.20%*	*80.40%*	*80.60%*	*80.80%*
EBITDA	2,222	(3,922)	4,051	5,639	5,288	4,142	4,531	4,991	5,535
% Margin	*55.12%*	*-128.34%*	*72.77%*	*76.74%*	*55.00%*	*55.20%*	*55.40%*	*55.60%*	*55.80%*
Less: Depreciation	1,416	1,326	1,263	1,263	1,242	1,320	1,455	1,615	1,804
EBIT	806	(5,248)	2,788	4,376	4,046	2,822	3,076	3,376	3,731
Less: Taxes	177	(1,155)	613	963	890	621	677	743	821
EBIT*(1-T)	629	(4,093)	2,175	3,413	3,156	2,201	2,400	2,634	2,910
Add: Depreciation	1,416	1,326	1,263	1,263	1,242	1,320	1,455	1,615	1,804
Less: Inc. in NWC		(174)	398	(202)	(26)	41	48	57	67
Less: CapEx	2,921	1,859	2,299	2,276	2,154	2,339	2,558	2,816	3,122
FCF to Firm	(876)	(4,452)	741	2,602	2,270	1,141	1,248	1,375	1,525
PV Factor					0.92	0.84	0.78	0.71	0.65
PV of FCF					2,086	963	968	980	998
PV of Terminal Value									26808.6

Firm Value	**32,803.2**
Less: Debt	$ 6,687
Plus: Cash	$ 654
Equity Value	**26,770.2**
Shares Outstanding	178
Share Price	**$ 150.39**

Drivers:	Historical 2017	Historical 2018	Historical 2019	Expected 2020	Projected 2021	Projected 2022	Projected 2023	Projected 2024	Projected 2025	Steps 1-5Y	Steps 6-10Y
Revenue Growth	N/A	-24.19%	82.17%	31.99%	7.50%	8.25%	9.00%	9.75%	10.50%	0.75%	0.25%
Margin Expansion:											
Gross Margin	79.34%	74.90%	78.41%	80.95%	80.00%	80.20%	80.40%	80.60%	80.80%	0.20%	0.10%
EBITDA Margin	55.12%	-128.34%	72.77%	76.74%	55.00%	55.20%	55.40%	55.60%	55.80%	0.20%	0.10%
Depreciation (% of Sales)	35.1%	43.4%	22.7%	17.2%	17.39%	17.59%	17.79%	17.99%	18.19%	0.20%	0.10%
Net Working Capital:											
A/R	$ 615.0	$ 337.0	$ 671.0	$ 500.0	$ 473.6	$ 514.7	$ 563.3	$ 620.7	$ 688.6	365	365
DSO	55.69	40.25	43.99	24.84	24.94	25.04	25.14	25.24	25.34	0.10	-0.05
Inventory	$ 37.0	$ 33.0	$ 62.0	$ 45.0	$ 44.9	$ 48.6	$ 52.8	$ 57.9	$ 63.8	365	365
DIO	16.2	15.7	18.8	11.7	11.8	11.9	12.0	12.1	12.2	0.10	0.05
A/P	$ 179.0	$ 71.0	$ 36.0	$ 50.0	$ 49.9	$ 53.9	$ 58.6	$ 64.1	$ 70.6	365	365
DPO	78.4	33.8	10.9	13.0	13.1	13.2	13.3	13.4	13.5	0.10	0.05
NWC	$ 473.0	$ 299.0	$ 697.0	$ 495.0	$ 468.6	$ 509.4	$ 557.6	$ 614.4	$ 681.8		
Change in NWC		$ (174.0)	$ 398.0	$ (202.0)	$ (26.4)	$ 40.8	$ 48.1	$ 56.9	$ 67.3		
CapEx (% of Sales)	72.46%	60.83%	41.30%	30.97%	31.07%	31.17%	31.27%	31.37%	31.47%	0.10%	-0.05%

Oil & Gas Metrics

Net Proved Reserves - Oil (MMbbls)	FY19	FY20	FY21
Reserves, BOY	817	941	1,049
Changes attributable to:			
Revisions	(93)	(56)	(167)
Improved recovery	-	-	-
Extensions & Discovery	323	249	399
Purchases	18	3	235
Sales	(37)	(0)	(48)
Production	(87)	(88)	(109)
Reserves, EOY	941	1,049	1,359
Researves w/o Sale/Purchases	960	1,046	1,172
Proved Developed Reserves	457	443	620
% Developed	0	0	0
Proved Undeveloped Reserves	254	316	308
% Undeveloped	0	0	0

Net Proved Reserves - NGLs (MMbbls)	FY19	FY20	FY21
Reserves, BOY	817	941	1,049
Changes attributed to:			
Revisions	(93)	(56)	(167)
Improved Recovery	-	-	-
Extensions & Discovery	323	249	399
Purchases	18	3	235
Sales	(37)	(0)	(48)
Production	(87)	(88)	(109)
Reserves, EOY	941	1,049	1,359
Reserves w/o Sale/Purchases	960	1,046	1,172
Proved Developed Reserves	165	192	286
% Developed	17.5%	18.3%	21.1%
Proved Undeveloped Reserves	65	97	144
% Undeveloped	6.9%	9.3%	10.6%

Revenue - TOTAL	FY19	FY20	FY21
Revenue per BOE of Production	$ 38.38	$ 25.59	$ 49.61
Expenses			
Production Costs	8.16	7.06	8.84
Other operating expenses	-	-	-
Depreciation, depletion, amortization	13.87	11.60	8.90
Taxes other than on income	-	-	-
Asset impairement and related items	7.80	55.91	-
Exploration Expense	-	-	-
Pre-Tax	8.55	(48.98)	31.87
Taxes	2.40	1.77	3.10
Net Income per BOE	**6.15**	**(50.75)**	**28.77**

Net Proved Reserves of Natural Gas (Bcf)	FY19	FY20	FY21
Reserves, BOY	1,049	1,119	1,607
Changes attributed to:			
Revisions	(150)	300	195
Improved Recovery	-	-	-
Extensions & Discovery	319	316	720
Purchases	20	4	303
Sales	(21)	(1)	(70)
Production	(98)	(131)	(169)
Reserves, EOY	1,119	1,607	2,586
Reserves w/o Sale/Purchases	1,120	1,604	2,353
Proved Developed Reserves	825	1,085	1,771
% Developed	73.7%	67.5%	68.5%
Proved Undeveloped Reserves	294	522	815
% Undeveloped	26.3%	32.5%	31.5%

Barrels of Equivilant (BOE) Reserves	FY19	FY20	FY21
Reserves, BOY	992	1,127	1,316
Changes attributed to:			
Revisions	(118)	(6)	(135)
Improved Recovery	-	-	-
Extensions & Discovery	376	302	519
Purchases	21	4	285
Sales	(41)	(1)	(60)
Production	(103)	(110)	(137)
Reserves, EOY	1,127	1,316	1,788
Reserves w/o Sale/Purchases	1,147	1,313	1,563
Developed Reserves	760	816	1,201
% Developed	67.4%	62.0%	67.2%
Proved Undeveloped Reserves	368	500	588
% Undeveloped	32.7%	38.0%	32.9%
New Reserves, (all sources)	238	299	609
New Reserves through drillbit	258	296	384

Cost Incurred (in millions)			
Exploration	1,915	1,098	1,223
Property Acquisition	612	119	4,634
Development	956	381	516
Total Costs	**3,483**	**1,598**	**6,373**