

Diamondback Energy, Inc.		Symbol: FANG
Analyst		Michael Bove
Buy below		\$114.84
Sell above		\$157.39
Probability of Price Increase		97%
Last Price		\$97.76
Intrinsic Value		\$126.41
Target Dividends		\$0.50
Target Price		\$143.04

Investment Thesis

Solid Energy Company with Incredible Growth

I am continuing coverage of Diamondback Energy with a BUY rating below \$114.84 and a \$143.04 price target. Diamondback Energy is a strong energy company that has demonstrated incredible flexibility in their operational strategy that is reaping better than expected results after completing a merger with Energen. FANG has shown particular skill in acquiring energy companies (with substantial value creation to shareholders during periods of falling crude oil prices.). FANG is a mature company that follows an aggressive philosophy of keeping spending below the quarterly cash flow and prioritizes cost reductions. As an added bonus, FANG is boosting their dividend from \$0.50 to \$0.75 per share.

For the long:

1. Proven History of Successful Acquisitions:

FANG has demonstrated consistent success in providing value to shareholders. Since their IPO in 2012, they have acquired at least 6 other energy companies. Despite falling WTI crude oil prices, these investments have returned a substantial amount of value to shareholders. Their most recent acquisition of Energen is also performing well. FANG is "realizing synergies faster than expected" in cost savings and production growth for their acquisition of Energen.

2. Disciplined View of Capital and Growth:

FANG has a budget in place that is highly flexible. As an established company, they recognize the variation in WTI crude oil prices and have shown that they can readily adapt to those price changes. Weakness in WTI in the 4th quarter caused them to briefly outspend their free cash flow. They responded to this market condition by reducing activity and dropping operating wells and completion crews. Furthermore, they are trimming their capital budget while still forecasting production growth.

3. Our Portfolio Needs:

Based on the officers' findings in their Macro report, we need more allocation to the energy sector. FANG is a strong company with a proven history of returning value to shareholders. We currently hold a small portion of our portfolio in FANG and we are still profitable in that position despite the recent oil downturn. We should purchase even more shares of FANG and take advantage of the dip in oil prices.

For the short:

1. Oil Risk:

Like all oil companies, FANG is exposed to risk if the price of WTI falls. Slowing economic growth in the world has put pressure on oil prices as WTI has fallen from a high of around \$77.00 per barrel to the current price of around \$56.00 a barrel.

2. Horizontal Drilling:

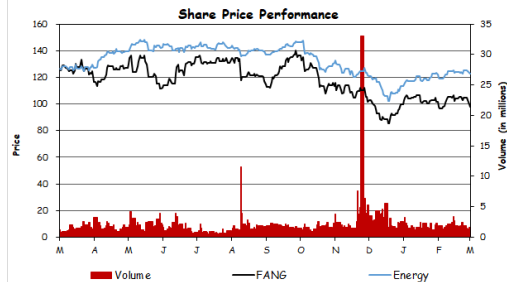
As opposed to vertical drilling, horizontal drilling is less efficient in extracting oil because of higher costs. Although this hasn't impacted FANG yet, it could be a potential pressure on margins in the future as their costs rise due to the "easy" oil having already been extracted.

Key Catalysts for price change:

- Intense capital discipline yielding free cash flow
- Strengthening oil prices
- Acquisitions performing better than expected.

Valuation

My \$143.04 price target is derived from Discounted Unlevered Free Cash Flow estimates.



Description

Diamondback Energy, Inc., an independent oil and natural gas company, focuses on the acquisition, development, exploration, and exploitation of unconventional and onshore oil and natural gas reserves in the Permian Basin in West Texas.

Sector	Energy
Industry	Oil, Gas and Consumable Fuels
Last Guidance	December 11, 2018
Next earnings date	NM

People

- Stice, Travis, CEO & Director
- Hollis, Michael, President, COO & Director
- Dick, Teresa, Chief Accounting Officer, Executive VP & Assist
- Pantenmuehl, Russell, Executive VP & Chief Engineer
- Malnar, Paul, Executive Vice President of Exploration & Busin
- Van't Hof, Kees, CFO & Executive VP of Business Development

Top Competitors

Parsley Energy, Inc.	Cabot Oil & Gas Corporation
WPX Energy, Inc.	--
Continental Resources, Inc.	--
Cimarex Energy Co.	--
Concho Resources Inc.	--

Market Statistics

Market Capitalization (mil)	\$16,069.94
Last Price per share	\$97.76
52 week high	\$140.78
52-week low	\$85.19
Volatility	35.54%
Daily volume (mil)	1.62
Short interest	3.29%
Days to cover short interest	2.39
Beta	1.44

Ownership Change in Ownership ("Input"/month)

Shares outstanding (mil)	164.38	
Diluted shares outstanding (mil)	104.93	
Options and Warrants (Shares equivalent)	0.11	
% shares held by institutions	104%	0.49
% shares held by investments Managers	84%	-0.28
% shares held by hedge funds	9.84%	-0.05
% shares held by VC/PE firms	0.031%	N/A
% shares held by insiders	0.42%	15.30%
Poison Pill Type	NONE	

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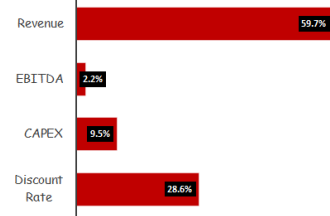
Financials			
Profitability	FANG (LTM)	FANG Historical	Peers' Median (LTM)
Return on Capital	4.2%	5.66%	8.29%
Adjusted EBITDA Margin	72.1%	36.35%	66.03%
Return on Equity	6.2%	8.1%	15.5%
Adjusted Net margin	38.1%	29.3%	18.2%
Invested Funds	FANG (LTM)	FANG Historical	Peers' Median (LTM)
Cash/Capital	2.1%	1.2%	1.2%
NWC/Capital	-3.3%	-11.6%	-2.7%
Operating Assets/Capital	101.2%	110.9%	94.7%
Goodwill/Capital	0.0%	0.0%	0.0%
Capital Structure	FANG (LTM)	FANG Historical	Peers' Median (LTM)
Total Debt/Market Cap.	0.29	0.12	0.33
Reported Cost of Borrowing	4.1%		5.1%
Cash Interest/Total Debt	2.6%		4.5%
CGFS Credit Rating	CCC		CC
Credit Model Rating	bbb		bbb-
Probability of Default	1.09%		1.31%
Cost of Capital	CGFS Credit Rating	Credit Model Rating	Probability of Default
Implied Cost of Borrowing (FANG)	6.5%	5.6%	7.1%
Implied Cost of Borrowing (Peers)	7.1%	5.7%	8.2%
Cost of New Debt Estimate	7.5%		
Market Risk Premium Estimate	6.0%		
Cost of Equity Estimate	13.5%		
WACC Estimate	11.7%		

Quarterly Earning Surprises (Actual Vs. Median Estimates)	
Revenue	
12/31/2017	6.26%
3/31/2018	9.11%
6/30/2018	8.89%
9/30/2018	3.36%
12/31/2018	-2.73%
Mean (Standard Error)	4.98% (1.02%)
EBITDA	
12/31/2017	10.10%
3/31/2018	1.71%
6/30/2018	20.26%
9/30/2018	-8.57%
12/31/2018	-19.16%
Mean (Standard Error)	4.98% (5.03%)

Valuation

DCF Valuation						
Base Year (Actual)	Revenue	EBITDA Margin	UFCF	WACC	ROIC	Price Per Share
year 1	\$4,222.20	74%	\$408.68	11.70%	6.83%	\$119.21
year 2	\$5,496.90	79%	\$1,365.31	11.83%	10.16%	\$135.86
year 3	\$6,461.90	79%	\$2,041.19	11.96%	10.81%	\$153.15
year 4	\$6,901.30	79%	\$2,596.41	12.09%	10.62%	\$170.53
year 5	\$7,259.20	81%	\$2,924.57	12.20%	10.78%	\$187.45
year 6	\$7,603.82	79%	\$2,504.54	12.30%	9.25%	\$203.61
year 7	\$7,931.44	77%	\$1,923.65	12.37%	7.92%	\$219.41
year 8	\$8,238.39	75%	\$1,282.86	12.43%	6.72%	\$235.49
year 9	\$8,521.07	74%	\$887.59	12.47%	5.61%	\$252.66
year 10	\$8,776.08	72%	-\$159.58	12.50%	4.59%	\$271.89
year 11	\$9,000.22	70%	-\$938.95	12.53%	3.62%	\$294.35
year 12	\$9,230.09	70%	-\$967.56	12.55%	3.72%	\$321.23
year 13	\$9,465.83	70%	-\$996.93	12.58%	3.79%	\$353.14
year 14	\$9,707.59	70%	-\$1,027.04	12.60%	3.85%	\$390.77
year 15	\$9,955.52	70%	-\$1,057.92	12.63%	3.90%	\$443.52
Continuing Period	\$10,209.78	70%	\$4,533.07	12.65%	12.65%	
Relative Valuation					Asset Based Valuation	
Multiple	EV/Rev (FW)	EV/EBITDA (FW)	P/BV (TTM)	P/E (FW)	Recovery Rate	100%
Median (Peers)	4.7x	6.3x	1.2x	14.0x	Capital	\$21,246.44
Base	Revenue (NTM)	EBITDA (NTM)	Book Value (LTM)	Net Income (NTM)	Intangibles	\$0.00
FANG	\$4,456.19	\$3,357.19	\$3,868.86	\$1,235.80	Claims	\$5,372.49
Implied EV	\$20,880.98	\$21,168.76				
Total Net Claims	\$4,079.41	\$4,579.41				
Implied EQ	\$16,301.57	\$16,589.35	\$16,258.19	\$17,361.24		
Valuation Summary						
Model	Intrinsic Value	Target Price	Weight			
DCF Valuation	\$103.89	\$119.21	40.00%			
EV/Rev (FW)	\$185.19	\$172.80	25.00%			
EV/EBITDA (FW)	\$157.93	\$175.86	0.00%			
P/BV (TTM)	\$154.78	\$172.34	25.00%			
P/E (FW)	\$165.28	\$184.07	0.00%			
Asset Based Valuation	\$151.12	\$168.25	10.00%			
Price per Share	\$134.16	\$150.79	100%			

Sensitivity Attribution Analysis



Intrinsic Value Distribution--Probability (Upside)=97%

