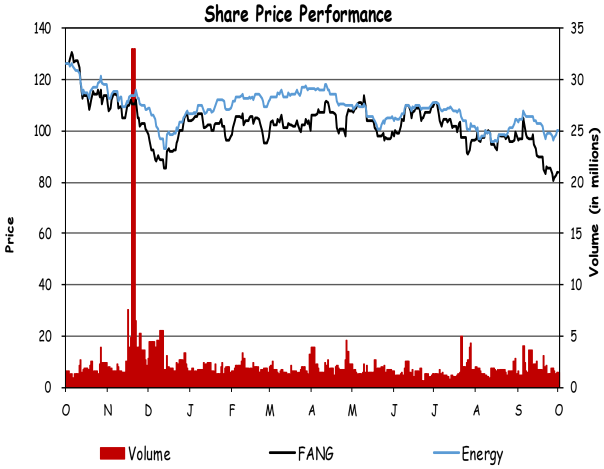
Alexander Zurlo

Write-Up 1

Diamondback Energy, Inc.	Symbol: FANG
Analyst	Alexander Zurlo
Buy below	$81.02
Sell above	$96.70
Probability of Price Increase	97%
Last Price	$83.64
Intrinsic Value	$81.08
Target Dividends	$0.50
Target Price	$96.72

Share Price Performance



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	November 5, 2019

People

Stice, Travis, CEO & Director

Dick, Teresa, Chief Accounting Officer, Executive VP & Assist

Pantermuehl, Russell, Executive VP & Chief Engineer

Van't Hof, Kaes, CFO & Executive VP of Business Development

Wesson, Daniel, Senior Vice President of Operations

Lawlis, Adam, Vice President of Investor Relations

Top Competitors

Paradox Interactive AB (publ)	Cimarex Energy Co.
Concho Resources Inc.	Continental Resources, Inc.
Magellan Midstream Partners, L.P.	--
Cimarex Energy Co.	--
Parsley Energy, Inc.	Whiting Petroleum Corporation

Investment Thesis

Sink Your Teeth into Profits with FANG – A Unique Short and Long Term Value Prospect.

I am initiating continuing coverage of Diamondback Energy, Inc. (Nasdaq:FANG) with a limit buy at $80.00 a share, and a conservative 1 year target price of $107.26. I view FANG as a best in class oil and natural gas company whose 97% upside for short-term gains will fuel large returns in a long position, centered on the company's bright growth potential. Given the markets extreme discounting of this company in response to factors unrelated to it, I am presenting an ideal entry point to take advantage of a definite "buy low, sell high" strategy supported by solid financials, fundamentals, and coupled by promising growth of the company and the Permian basin. Specifically, Diamondback Energy is an oil and natural gas company whose operations focus on the acquisition, development, exploration, and exploitation of onshore oil and natural gas. As such, FANG'S role in the oil industry value chain is to preform exploratory testing of wells, drill, extract, and collect WTI oil, -collect its byproducts (natural gas and gas liquids) - and transport its crude oil for processing at later stages in the value chain. Furthermore, FANG has continually been able to complete this process in a way that has positioned them to be able to make strategic acquisitions to capture the growth potential of the Permian and the industry at large, as well as maintain peer leading growth, cash flow, and overall underlying financials.

For the long:

1. Growth prospects of the Permian Basin: The Permian basin, located in the midland of Texas stretching into New Mexico, is up and coming real estate to the oil industry, whose output production is expected to rival the top yielding oilfields of abroad, including the infamous Ghawer oil field, in the future. The Permian is divided into several sections or platforms, each containing various formations of shale, whose composition yields various volumes of oil and natural gas. Moreover, Diamondback operates active wells on each of the Permian's platforms, primarily dealing in the Delaware and Midland basins. Further, the Permian yields WTI or Western Taxes Intermediate Oil, the highest quality oil on the planet, across each of its platforms. As such, Diamondback only deals the most valuable and versatile oil to the market. Further, the USGS has estimated in the Delaware and Midland Basins alone, a protected 46.3 and 4.245 Billion barrels of oil respectively remaining in undiscovered resources. Secondly, Permian oil production from 2007 to 2018 has risen from just under one to close to four million barrels of oil a day. The DUC well count (drilled but uncompleted) has also drastically risen from roughly 600 to over 4000 from 2013 to 2018.

2. Strategic Acquisitions: Over the past 8 years, FANG has made numerous acquisitions in order to capitalize on the growth prospects of the Permian basin and their operations as a whole. This includes the company's most recent purchase of Energen, an energy company focusing in hydrocarbon exploration, for $9.2 billion dollars. FANG also has two subsidiary companies that both operate in the Permian basin as well, Viper Energy Partners, and Rattler Midstream, whose recent IPO in May of 2019 netted FANG $720 million in additional cash flows. This also presents FANG with the ability to diversify its operations and generate alternate sources of revenue.

3. Low Cost Structure: FANG'S operations also benefit from an unbelievably low cost structure that allows them to extract oil at a high margin relative to the price/barrel. The company's 2019 operating cost per barrel was a meager $8.67, up marginally from $8.44 in 2018. Thus, still illustrating FANG's ability to maintain this low cost structure. In fact, based on the company's most recent 10-k, the 2018 overall margin per boe assuming a price of 54.66/boe was 70.25%. Moreover, the most recent Q2 company data shows a decline of 7% and 16% in well costs in the Midland and Delaware Basins respectively. (FANG's two most prominent operating basins). No matter what happens in the Marco economy, the world will still need oil. The fact that FANG deals in only in the most valuable and versatile variety of oil at such a profitable cost will allow them to generate constant positive cash flows, even the event of a depressed economy. Given the standing of their operations, it is estimated that FANG will be able to remain profitable even at as low of a price as $40/boe WTI in the near future.

For the short:

1. Strong Underlying Financials: The short-term declines in FANG's stock price have been a result of factors unrelated to the fundamentals of the company or the industry. As such, the company's solid financial state will quickly take advantage of the extreme discounting of their stock by the market; and will support a strong recovery in price in the near term. A recent parting of the company's COO for personal reasons unrelated to the company has been the major catalyst contributing to negative investor sentiment. However, reference to the company's price graph will depict a drop in the price at this time without any change in volume, indicating that this large decline in price is unrelated to the underlying operations of the company or the economy. Furthermore, uncertainty about the economy's outlook domestically and abroad has led many investors to be skeptical of the future prices of oil. Obviously, the supply and demand for oil as a result, is directly tied to the operations of the company. Hence, investors are viewing this uncertainty as an increased risk that has played a major factor in the stock's price decline over the past several months. (Not the most recent short-term decline). However, given the cost structure advantage stated above, and the financial state of the company, -including a net profit margin of 35%, operating margin of 40%, ROE,ROI, and ROA of 10%,7%, and 6.3% respectively - the strength of FANG'S operations will be sure to significantly boost the stock price in the coming quarters, as well as guide it through negative investor sentiment. Additionally, the company has seen an 85.6% YoY growth in revenue, 45% growth YoY in gross profit, 75% growth YoY in EBITDA, and a 27% growth YoY in net income, all from June of 2019. Lastly, the company has seen promising value creation as of late, with a ROIC to WACC ratio of 6.4 prior to the COO related price decline. The current value creation ratio sits at 1.4.

Key Catalysts for price change

- Internal corporate governance (short-term driver)
- Macro-Economic conditions as they pertain to global stability and the international and domestic economies; taking into account factors such as trade wars, depressed economies, conflicts between nations, etc.
- The correlation of oil futures to the macro-economy, and thus, the correlation between oil futures and oil prices.

Valuation

My $107.26 price target is derived from a combination of Discounted Unlevered Free Cash Flow (DCF) and an EV/EBITDA multiple valuation methods. EV/EBITDA is one of the most frequented and standard multiples for valuating the oil industry.

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Cost of Capital Estimates

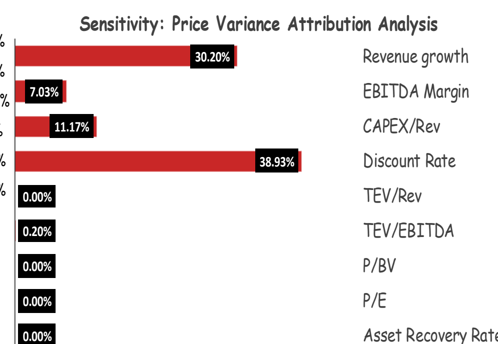
	CGFS Credit Rating	Credit Rating Model	Probability of Default ModelModel
Implied Cost of Borrowing (FANG)	6.5%	4.5%	7.7%
Implied Cost of Borrowing (Peers)	5.3%	4.7%	7.3%
	Base Year	**Explicit Period (15 years)**	**Continuing Period**
Cost of New Debt Estimate	4.73%	7.00%	7.00%
Country Risk Premium Estimate	7.00%	7.00%	7.00%
Cost of Equity Estimate	11.73%	14.00%	14.00%
WACC Estimate	9.89%	12.04%	12.04%

Forecast Assumptions

Fiscal Year	Revenue Growth	EBITDA Margin	CAPEX/Revenue	DPR/CAPEX	Other	
2018 - Base Year (Actual)	85.20%	**71.7%**	160.9%	0.18	SBC/Revenue	1.23%
changed2019-year 1	30.00%	**77.9%**	69.6%	0.51		Constant/same as LTM
changed2020-year 2	10.00%	**77.0%**	58.8%	0.56	Lease term	10
2021-Year 3	10.00%	**81.7%**	55.2%	0.62	Rent Expense/Revenue	0.27%
2022-year 4	5.00%	**80.2%**	48.3%	0.66		Tappers off to historical average
2023-year 5	5.00%	**80.2%**	45.5%	0.70	R&D life	10
year 6	5.00%	**77.5%**	46.0%	0.72	R&D Expense/Revenue	0.00%
year 7	5.00%	**76.7%**	46.4%	0.75		Constant/same as LTM
year 8	5.00%	**76.0%**	46.8%	0.78	LIFO Reserve	Tappers off to zero
year 9	5.00%	**75.2%**	47.2%	0.81	Non-operating pension costs	Tappers off to zero
year 10	2.50%	**74.5%**	47.6%	0.83	Net financing pensions costs	Tappers off to zero
year 11	2.50%	**73.7%**	48.0%	0.86	Overfunded pension plans	Tappers off to zero
year 12	2.50%	**73.0%**	48.4%	0.89	Capitalized interests	Constant/same as LTM
year 13	2.50%	**72.2%**	48.8%	0.92	Dividends/Revenue	2.11%
year 14	2.50%	**71.5%**	49.2%	0.94	Tax Rate	21.84%
year 15	2.50%	**70.0%**	49.6%	0.97		
Continuing Period	2.52%	**70.0%**	50%	1.00		

Simulation Assumptions

Random Variables	Distribution Assumption	MAX	Likelly	MIN
Deviations in annual Revenue Growth--Expl. Per.	Triangular	2.00%	0%	-1.00%
Deviations in annual Revenue Growth --Cont. Per.	Normal	1.52%	0%	-1.52%
Deviations from EBITDA Margin base annual estimates	Triangular	14.23%	0%	-23.75%
Deviations from CAPEX/Revenue base annual estimates	Triangular	20.00%	0%	0.29%
Deviations from Kd base annual estimates	Triangular	2.16%	0%	-4.29%
Deviations from CRP base annual estimates	Triangular	0.82%	0%	-2.92%
Deviations from TEV/Revenue base estimate	Triangular	5.28	0%	-1.48
Deviations from TEV/Revenue base estimate	Triangular	10.73	0%	-1.45
Change in P/BV (TTM)	Triangular	13.98	0%	-1.01
Change in P/E (FW)	Triangular	17.00	0%	-4.93
Recovery Rate	Triangular	10.00%	0%	-10%



Valuation

DCF Valuation

	Base	Explicit Period (Average)	Continuing Period
Revenues	$3,001.03	$5,690.55	$7,521.08
EBITDA Margin	71%	76%	70%
UFCF	-$1,646.24	$1,439.44	$4,848.91
WACC	9.89%	12.04%	12.04%
ROIC	4.64%	7.54%	12.04%

Relative Valuation

	Median Justified Multiple	Basis	Implied Equity Value
EV/Rev (FW)	3.6x	$4,023.19	$8,888.82
EV/EBITDA (FW)	4.9x	$3,121.99	$9,620.09
P/BV (TTM)	1.2x	$14,270.43	$16,691.55
P/E (FW)	13.8x	$963.32	$13,318.65