A Financial Analysis and Valuation of Diamondback Energy

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Abstract. Because of the importance of its products and huge value, the oil and gas industry itself occupies an important position in the national economic system. However, the development of this industry is unbalanced and insufficient, with large differences in market size, liquidity, solvency, profitability, valuation, and growth potential, and few companies have achieved good performance in all of these dimensions. This study delves into the unbalanced development and varied performance metrics among key petrochemical companies listed in the U.S. stock market, utilizing both fundamental analysis and non-financial analysis method, as well as to conduct a specific study on the competitive situation of Diamondback Energy. This study has elucidated that Diamondback Energy lags behind its peers in terms of liquidity and solvency. However, it is worth noting that despite macroeconomic challenges such as economic downturns and industry-wide downturns, its profitability remains relatively strong within the industry. Additionally, it holds a certain advantage over its peers in terms of financial valuation and growth potential, making it a growth-oriented enterprise. The study suggests that investors should consider market volatility and the company's management risk when entering the oil and gas industry in order to maximize returns.

Keywords: Oil and gas industry; Enterprise risk management; Fundamental analysis; non-financial analysis.

1. Introduction

The oil and gas industry are one of the largest and most important industries in the world in terms of value. Oil is the blood of industry, and the health of the oil and gas industry is critical to the health of the global economic framework and supply chain system, affecting various sectors including manufacturing, transportation, and so on. Influenced by corporate history, internal management, marketing, capital operations and other factors, there are obvious differences within the oil industry, and competing companies in the same industry tend to have large differences in size, revenue and other aspects [1].

Diamondback Energy (FANG) is an independent oil and gas company with a market capitalization of approximately $3,474.4 million headquartered in Midland, Texas. In 2023, a Bloomberg news report noted that the company, along with Permian Resources, was one of the major contributors to the increase in flared off-gas from the Permian oil fields. In terms of within the oil and gas industry, the company is in the middle of the pack. In fiscal year 2023, the company's average production was 447,707,000 barrels of oil equivalent per day (bbl/d). As of December 31, 2023, the company owned mineral interests in approximately 493,769 net acres, consisting primarily of 349,707 net acres in the Midland Basin and 143,742 net acres in the Delaware Basin. In addition, Diamondback Energy's publicly traded subsidiary, Viper, owns mineral interests in approximately 1,197,638 gross acres and 34,217 net royalty acres in the Permian Basin, and Diamondback Energy operates approximately 49% of these net royalty acres [2].

Diamondback Energy is principally engaged in the acquisition, development, exploration and exploitation of unconventional onshore oil and natural gas reserves in the Permian Basin of West Texas. In addition, the Company's wholly-owned subsidiary, Rattler Midstream Operating LLC, owns and operates crude oil and natural gas gathering systems and provides services to Diamondback Energy and third-party customers, primarily under long-term, fixed-fee contracts. In fiscal year 2023, Diamondback Energy's total revenues were approximately 196,913,000 representing a total revenue growth rate of -15.46% over fiscal 2022, the first time since the outbreak that the company has experienced negative total revenue growth. However, its total revenue level is still higher than that of fiscal 2021 [3].

This paper attempts to deconstruct Diamondback Energy's financial ratios and other public data from the perspective of enterprise risk management and control, and analyze the competitive advantages and shortcomings of Diamondback Energy in terms of liquidity, solvency, profitability and return on investment by comparing the performance of Diamondback Energy with that of its U.S.-listed competitors, such as Chevron (CVX), Exxon Mobil (XOM) and Occidental Petroleum Corporation (OXY) [4]. Through a combination of quantitative analysis and qualitative research, it studies Diamondback Energy's current operations and future development prospects, and provide targeted recommendations for the company's management.

2. Performance Analysis

Liquidity, solvency and profitability are important factors that can be quantitatively reflected by the corresponding ratios. By comparing the performance of peer companies in these dimensions, it is possible to accurately portray Diamondback Energy's specific operating conditions in the past fiscal year, thus reflecting the company's competitive strengths and weaknesses in management, sales, and other areas. This section is intended to quantitatively examine the operations of the major companies in the U.S. petrochemical industry by comparing publicly available financial data, including those of these companies, with a view to measuring Diamondback Energy's relative position in the industry [5].

2.1. Liquidity

Table 1. Liquidity ratios of Diamondback Energy and its competitors.

Stock Code	Current Ratio	Quick Ratio	Cash Ratio
FANG	76.90%	73.91%	27.75%
CVX	127.50%	100.80%	25.49%
XOM	147.91%	109.45%	48.33%
OXY	91.55%	69.45%	15.59%

Data source: Yahoo Finance, Nasdaq

Overall, a comparison of the liquidity data of the four companies shows that Diamondback Energy does not have a competitive advantage in terms of liquidity (see Table 1). The company's relatively poor liquidity performance implies that its solvency is not outstanding among peer companies, thus the probability of facing liquidity risk is greatly increased [6].

From a current ratio perspective, Diamondback Energy has a relatively low current ratio of around 77%, which is not only well below the safe level of 200% current ratio, but also significantly inferior to Exxon Mobil, a much larger company in the same comparison sample. The current ratio is the ratio of current assets to current liabilities, and measures the ability of a company's current assets to be converted to cash to repay its short-term debt before it matures. Diamondback Energy's current ratio performance implies that, even if it sells all of its current assets, it will have difficulty in fully paying off all of the company's short-term debt before it matures. In general, unless the company is able to increase its liquid assets by selling fixed assets, trying to increase revenues, or entering into debt extension contracts with its creditors, there is a high likelihood that the company will face a liquidity crisis around the time its short-term debt comes due. This is a red flag that deserves the attention of managers and investors.

From the perspective of quick ratio, Diamondback Energy's performance is also not optimistic. Quick assets refer to the balance of the company's current assets after deducting inventories and prepaid expenses, mainly including cash, short-term investments, notes receivable, accounts receivable and other items, which means almost all the company's assets that can be realized immediately. The comparison shows that even though Diamondback Energy's inventory and prepaid expenses do not account for a significant portion of the company's assets, its quick ratio is still at the lower end of the range of companies in its industry. Like its current ratio, a low quick ratio suggests the possibility of potential liquidity risk.

From a cash ratio perspective, Diamondback Energy performs relatively well, but still has some distance to travel compared to the industry leaders. The cash ratio measures only the most liquid of all assets and is therefore the most conservative of the three liquidity ratios. Thus, a better cash ratio performance also suggests that there is still an element of optimism in the company's liquidity performance. The company's ability to repay its current debt without relying on inventory sales and accounts receivable is relatively strong.

In addition, it is worth noting that when examined in the time dimension, Diamondback Energy's liquidity performance in recent years has generally shown an upward trend amidst fluctuations, indicating that the company's financial management is gradually improving and its awareness of avoiding liquidity risk has significantly increased.

2.2. Solvency

Table 2. Solvency ratios of Diamondback Energy and its competitors

Stock Code	Total Debt Ratio	Long-term Debt Ratio	Times-interest-earned ratio
FANG	0.399	0.229	25.274
CVX	0.385	0.078	64.079
XOM	0.456	0.104	63.171
OXY	0.283	0.242	7.803

Data source: Yahoo Finance, Nasdaq

Overall, Diamondback Energy's solvency is only in the middle of the industry and does not have a considerable competitive advantage (see Table 2). This also means that the company's debt is under pressure, and it cannot rule out the possibility of repayment difficulties or a significant increase in financial costs in the future [7].

From the point of view of the total debt ratio, Diamondback Energy's ratio is relatively high, ranking second among the selected sample companies, and the company's solvency is relatively tight. As a comprehensive indicator for evaluating a company's level of indebtedness, the total debt ratio is able to reflect the degree of safety of creditors in granting loans. It also implies that Diamondback Energy's subsequent financing costs may be relatively high.

Diamondback Energy's performance continues to be unimpressive when examined at the level of long-term debt ratios. Long-term debt ratio is an indicator of a company's ability to repay its assets for non-current liabilities during liquidation, and the company's relatively high long-term debt ratio implies that it is under pressure to settle its non-current liabilities. However, it is worth noting that by comparing the long-term debt ratio with the total debt ratio, the company's short-term debt accounts for a relatively low percentage, which also means that its short-term solvency can be guaranteed to a certain extent.

In terms of times-interest-earned ratios, Diamondback Energy is a mediocre performer but still leaves a large safety redundancy overall. The interest coverage multiple is a measure of a company's ability to pay interest on its debt. While on a relative basis, the company's interest coverage multiple is still quite far from the industry leader’s, it still has a significant competitive advantage on an absolute level.

2.3. Profitability

Table 3. Profitability ratios of Diamondback Energy and its competitors.

Stock Code	Profit Margin	Operating Margin	Asset Turnover
FANG	84.90%	54.33%	31.82%
CVX	26.83%	13.21%	76.41%
XOM	31.31%	13.07%	90.69%
OXY	60.07%	21.87%	38.92%

Data source: Yahoo Finance, Nasdaq

Compared to other companies in the industry, Diamondback Energy's performance in terms of profitability is outstanding, with an almost overwhelming advantage over its peers in terms of gross profit margin and operating profit margin (see Table 3). Diamondback Energy's higher gross margin, which amount to more than three times that of Chevron, a veteran petrochemical industry leader, demonstrates its vastly superior position in terms of profitability. Of course, this performance may also be related to its small size and relatively small total assets. In terms of absolute earnings, Diamondback Energy still has a lot of room to catch up.

Similarly, Diamondback Energy's operating margin is clearly superior. However, while this indicator remains high in absolute terms, it has shrunk significantly relative to gross margin. This means that the company's operating and management costs are relatively high, and that there are areas that need to be optimized in the everyday operations of the business.

However, Diamondback Energy's performance in terms of asset turnover ratio is clearly unsatisfactory, ranking at the bottom of the sample of all companies in the same industry with a low value, which is significantly different from the company's performance in the two indicators of gross profit margin and operating profit margin. The oil and gas industry is an asset-heavy industry with stable net profit margins and obvious economies of scale. The company is relatively small in size, and thus has an inherent disadvantage in the level of asset turnover.

3. Valuation

3.1. Forecast

Table 4. Financial indicators of Diamondback Energy and its competitors.

	FANG	CVX	XOM	OXY
Share price	187.42	154.02	109.56	61.96
TTM EPS	18.01	13.6	9.52	3.69
NTM EPS	17.74	12.43	8.72	3.31
EPS growth rate	-1.50%	-8.60%	-8.40%	-10.30%
Revenue growth rate	5.44%	-0.32%	-3.08%	-103.11%
TTM P/E	10.41	11.33	11.51	16.79
NTM P/E	10.56	12.39	12.56	18.72
PEG	Not Applicable			

Data source: NASDAQ (stock price data as of March 13, 2024 at 9:44 p.m. ET.)

A review of the financial metrics of Diamondback Energy and its peers reveals that the company is an outperformer overall, with a clear advantage over its competitors in terms of valuation and future growth (see Table 4). Diamondback Energy is relatively prominent when it comes to the performance of the figure of EPS, which is the highest among the companies in the sample and has a significant lead gap. Higher EPS means higher profitability and greater value, as investors will pay more for a company's stock if they perceive it to be more profitable relative to its share price. However, the NTM EPS ratio has declined relative to the TTM EPS ratio, which is a common phenomenon that exists in the industry, implying that there exist common challenges to profitability across the industry in the coming fiscal year. However, Diamondback Energy has the lowest rate of decline, which means that there is some assurance of stability in its profitability.

Diamondback Energy's performance in terms of Revenue growth rate is even more impressive, as it is the only company in the selected sample to achieve positive revenue growth. The other companies' expected revenues declined more or less, with Occidental Petroleum's revenues falling by more than 100%. Again, this proves that the company's profitability is relatively stable and that it has been able to cope with the generalized crisis in the market.

Diamondback Energy also performs well in terms of P/E ratio. The relatively low P/E ratio among its peers implies that Diamondback Energy is a growth-oriented company, its current share price is undervalued by the market, and it has more room for growth in the future. In addition, its NTM P/E ratio has risen slightly compared to its TTM P/E ratio, implying that the market is recognizing it as a growing company, but the fundamentals of its stock as a growth stock have not changed.

It is worth noting that since all four companies have negative expected EPS growth rates, this means that none of their PEG ratios can be calculated. PEG Ratio is a metric that is obtained based on the P/E ratio in order to measure the future earnings growth rate of different companies. This phenomenon may be related to some of the risks and challenges common to the oil and gas industry, which are explained in more detail in the next section [8].

3.2. Risks

According to the company's financial results, Diamondback Energy and its controlled subsidiaries will face a number of acquisitions and some divestitures of non-core assets over the past year and the next few years. In 2023, Diamondback Energy achieved $310 million in revenue and performed well in terms of annual basic dividend adjustments, common share repurchases, etc. In 2024, Diamondback Energy will maintain essentially flat production volumes and reduce capital activities with a view to improving its capital efficiency. Overall, Diamondback Energy plans to continue to deepen production in several key oil and gas plays in the next fiscal year, balancing cash flow and debt size to maximize benefits to equity holders and creditors.

However, Diamondback Energy still faces a number of potential risks, mainly arising from the oil and gas industry in which it operates and its own management process. These risks will affect the company's level of revenue, the size of its debt, etc., and may be detrimental to the interests of equity holders and creditors as well as to the company's long-term development [9].

Firstly, the oil and gas energy industry itself will face uncontrollability and uncertainty in 2024 and beyond. The outlook for the oil and gas industry itself is uncertain due to the world situation, and there will be inevitable volatility on a number of levels, including price and production. At the same time, the company's oil production in the Permian Basin cannot be guaranteed.

Secondly, as far as the company's financial indicators are concerned, its risks related to liabilities cannot be ignored. The company has significant liquidity risk. The company's large indebtedness and poor solvency could adversely affect its financial position and prevent it from meeting its debt obligations, which could lead to significant additional liabilities in the future.

Finally, the company also has risks associated with pending acquisitions. Its ability to complete the Endeavor Acquisition is subject to various closing conditions, and these constraints could result in the failure to complete the Endeavor Acquisition. In the event that an unanticipated termination of the acquisition occurs, Diamondback Energy's reputation would be damaged and it would incur high compensation costs [10].

In addition, the company will face uncertainties arising from a range of market policy changes, including energy policy, environmental policy, market policy, etc., and will need to cope with the impacts of climate change and possible political and military crises. Together, these potential crises form a risk system that Diamondback Energy has to face. The company has to designate appropriate plans and plans at the management level in order to be able to effectively protect against future unfavorable factors.

4. Conclusion

In conclusion, Diamondback Energy, a medium-sized but still significant player in the US petrochemical industry, has major pitfalls in the financial perspective. This study has elucidated that it has a large gap with its peers at both the liquidity and solvency levels. However, it is worth recognizing that its profitability is still more prominent in the industry in which it operates, despite the macro situation that includes a downturn in the economy and an industry-wide downturn. At the same time, it also has a certain leading edge over its peers in terms of financial valuation and room for growth, making it a growth-oriented enterprise.

Examined from an investor's perspective, this is a company that is undervalued by the market despite certain risk factors. Considering the growth dimension of the stock, the company's stock has more room for growth, the stock price is low, and holding the company's stock for a long period of time can bring large gains. For investors, although the growth trend of the company's stock is relatively obvious, in order to ensure the maximization and stability of their own interests, they must continue to observe the company's management, examine its market performance, and comprehensively study the impact of the macroeconomic situation on the petrochemical industry as well as Diamondback Energy, in order to timely adjust their positions. At the same time, investors should consider holding a combination of stocks of different companies in the same industry, or even different industries, in order to maximize the returns.

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