AP CAPITAL RESEARCH

M&A Deal of The Week

DIAMONDBACK ENERGY X ENDEAVOR

WRITTEN BY
Samuel Thompson

EDITED BY
AVISH PATEL

DATE
19th March 2024

Executive Summary

M&A DEAL OF THE WEEK

Deal Summary

- On the 12th of February 2024, Diamondback Energy (NASDAQ: FANG) announced that it had entered into a definitive merger agreement with Endeavor Energy Resources, a privately held company, in a cash and stock transaction valued at approximately $26 billion. Diamondback Energy stock rose 10% as a result of this news.
- This deal follows Chevron's acquisition of Hess for $53 billion and ExxonMobil's acquisition of Pioneer Natural Resources for $60 billion in October 2023.
- This merger gives the new entity a considerable stake in the Permian Basin, a significant Oil field region that stretches across Texas and New Mexico. According to Reuters**,** the company would become the top solely Permian-based producer.
- As a result of this merger, the combined company is expected to experience annual synergies of $550 million, which will be realised in 2025, representing over $3.0 billion in net present value over the next decade.
- The combined entity is expected to produce approximately 816,000 barrels of oil equivalent per day (BOE/D), a significant increase from Diamondbacks' fourth-quarter average net production of 462,200 BOE/D.
- Endeavor founder Autry Stephens stated, "We believe Diamondback is the right partner for Endeavor" and that he believed this merger "has a high likelihood of being the biggest upstream deal of 2024."

Deal Advisors

Diamondback Energy:
Financial Advisors:
Jefferies LLC and Citibank.

Endeavor:
Financial Advisors:
JP Morgan and Goldman Sachs.

Key Figures

- **Merger Value:** $26 billion
- **Closing date:** 2024 Q4
- **Synergies -** $550 million/year
- **Diamondback Market Cap:** $32.7 billion
- **Diamondback EV/EBITDA:** 6.4x
- **Diamondback EV:** $39 billion

Company Information

M&A DEAL OF THE WEEK

Diamondback Energy (NASDAQ: FANG)

- Founded in 2007, Diamondback Energy is an Oil and Natural Gas company that operates in the Permian Basin in West Texas and New Mexico. They operate through the upstream and midstream segments, with the upstream segment focused on the Permian Basin and the Midstream segment in the Delaware Basins.
- Diamondback's current oil production is an average of 462,200 BOE/D in the fourth quarter, up 18% from the 391,000 BOE/D recorded in the fourth quarter of last year.
- Concerning financials, Diamondback's 2023 revenue fell 15% from $9.57 billion in 2022 to $8.14 billion in 2023, as did net income, down 27% from $4.34 billion in 2022 to $3.17 billion in 2023. This fall was due to lower oil prices during the 2023 period compared to 2022, which negatively affected revenues. Recent fourth-quarter results yielded an EPS of $5.34, which places their P/E at 10.5x.

Endeavor Energy Resources

- Founded by billionaire Autry Stephens in 2000, Endeavor Energy Resources LP is an oil and gas extraction company operating in the Midland Basin of the Permian Basin in West Texas. Similar to Diamondback Energy, Endeavor Energy focuses on the upstream production/extraction of oil and natural gas and is predicted to produce approximately 350,000 – 365,000 BOE/D across its Midland Basin assets in 2024.
- They have approximately 470,000 net acres across multiple basins, 344,000 of which are in the Midland basin. Since 2016, they have completed over 1,100 oil and natural gas wells.
- Endeavor has more than 1,200 employees and is one of the largest private oil producers in the United States, excluding external territories.

Deal Rationale and Risk

M&A DEAL OF THE WEEK

Increased Oil Production and Financial Benefits

Increased net oil production (BOE/D)

- The combined entity is estimated to produce approximately 816,000 BOE per day in 2024, placing them 11th in the world compared to other upstream producers. This merger will also give the combined entity a pro-forma scale of approximately 838,000 net acres for asset production.

Financial Benefits (EOS and FCFPS accretion)

- Another reason driving this merger is the strategic, synergetic, and financial benefits this deal offers. The $550 million synergies expected to be realised in this deal consist of operating cost synergies, capital allocation/land synergies and corporate cost synergies, which account for a total of $550 million per year, generating a Net Present Value of over $3 billion.
- Other financial benefits include increased economies of scale and an expected increase of approximately 10% in free cash flow per share accretion in 2025.

Risk

Liquidity

- Regarding liquidity, recent earnings highlighted some potential issues within the company. Diamondback Energy's 0.77 current ratio is suboptimal - current assets ($1.62 billion) do not cover its current liabilities ($2.11 billion), which is concerning. Diamondback's dividend payout, accounting for 47% of net income, exceeds free cash flows as it represents 123% of FCFs, which raises questions about how they can finance their dividends while meeting liquidity constraints. Regarding their debt position, Diamondback's current D/E sits at 39% and has only decreased during the last 3 years.

Oil and Gas prices

- As with all companies in the Oil and Gas industry, profits are directly linked to oil prices, so a fall in oil or gas prices will have a dramatic effect on revenue and, therefore, profitability. An example of this is at the start of the pandemic when oil prices fell by 70% over 2 months, causing Diamondback to lose $4.27 billion in 2020.

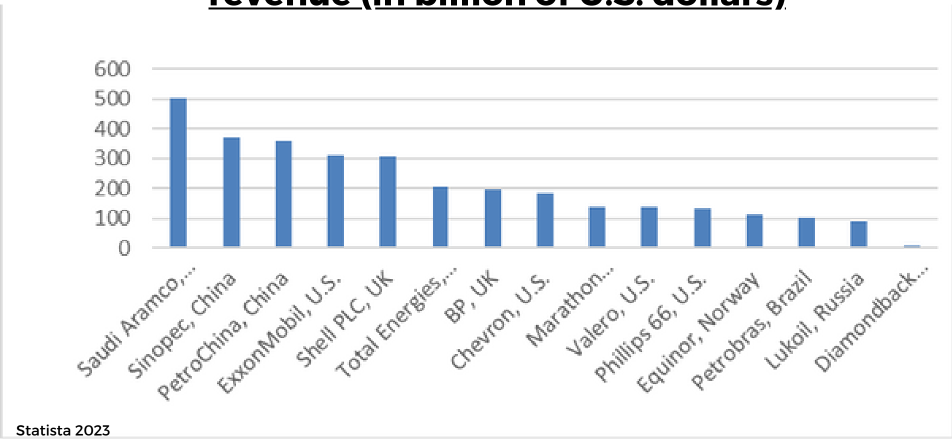
Industry Analysis

M&A DEAL OF THE WEEK

The Oil and Gas Industry

- The Oil and Gas industry is one of the biggest industries in the world due to the constant demand for petroleum products.
- The industry is currently dominated by Saudi Aramco, the world's biggest oil producer based in Saudi Arabia. They earned $502 billion in revenue in 2023, followed closely by Sinopec, a Chinese Oil and Gas company.

Leading global oil and gas producers based on 2023 revenue (in billion of U.S. dollars)



Industry growth rate

The Oil and Gas Industry in the U.S. is expected to grow at a **Compound Annual Growth Rate (CAGR) of 4%** from 2024 to 2029.

- This low CAGR in the Oil and Gas industry is not surprising, as the industry is already highly consolidated and has undergone significant growth during the 20th century.
- As low-carbon alternatives are explored further, the oil and gas industry may be on the verge of a potential decline in the coming decades. However, many companies have increased capital expenditures on alternative energy R&D to remain competitive within these regulations.

Threats

Climate change regulations threaten the Oil and Gas industry, as the production and consumption of oil and gas are very carbon intensive, contributing significantly to climate change. Many countries have set net-zero emission targets by 2050, which has forced many Oil and Gas companies to invest significantly in alternative energy sources like wind and solar.

Final Thoughts

M&A DEAL OF THE WEEK

Samuel Thompson

This move is very beneficial for Diamondback Energy as it provides a wealth of strategic benefits, including increased oil production and synergies. However, as Endeavor is a privately held firm, it is unknown to what extent this merger will increase Diamondback's profitability.

The only issue I see is not deal or regulatory (as there is little to no regulatory scrutiny) but regarding macroeconomic conditions. As mentioned earlier, oil and gas firm profitability heavily depends on oil and gas prices (unless you can manipulate global prices by increasing/reducing output), so a fall in prices due to a ceasefire due to a global conflict would impact profitability. Diamondback's Derivative department has somewhat mitigated the effects of falling prices as they have implemented a long put strategy to capitalise on falling oil prices.

SAMUEL THOMPSON
M&A ANALYST
Sjbt2015@gmail.com

AVISH PATEL
AP Capital Director
avishpatel92@gmail.com

Disclaimer

M&A DEAL OF THE WEEK