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FANG.OQ - Diamondback Energy Inc to Acquire QEP Resources Inc - M&A Call

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**OVERVIEW:**

Co. and QEP Resources entered into a definitive agreement under which FANG will acquire QEP Resources.

## CORPORATE PARTICIPANTS

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**Matthew Kaes Van't Hof** *Diamondback Energy, Inc. - CFO & Executive VP of Business Development*

**Travis D. Stice** *Diamondback Energy, Inc. - CEO & Director*

## CONFERENCE CALL PARTICIPANTS

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**Leo Paul Mariani** *KeyBanc Capital Markets Inc., Research Division - Analyst*

**Neal David Dingmann** *Truist Securities, Inc., Research Division - MD*

**Nitin Kumar** *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

## PRESENTATION

**Operator**

Ladies and gentlemen, thank you for standing by, and welcome to the Diamondback Energy Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions) I would now like to hand the conference over to your speaker today, Mr. Adam Lawlis, Vice President of Investor Relations. Please go ahead, sir.

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**Adam T. Lawlis** - *Diamondback Energy, Inc. - VP of IR*

Thank you, Catherine. Good morning, and welcome to Diamondback Energy's Conference Call to discuss the 2 Midland Basin transactions announced this morning.

During our call today, we will reference an updated investor presentation, which can be found on Diamondback's website. Representing Diamondback today is Travis Stice, CEO; and Kaes Van't Hof, CFO.

During this conference call, the participants may make certain forward-looking statements relating to the company's financial condition, results of operations, plans, objectives, future performance and businesses. We caution you that actual results to differ materially from those that are indicated in these forward-looking statements due to a variety of factors.

Information concerning these factors can be found in the company's filings with the SEC, and are also posted on Page 2 of the investor presentation posted to our website this morning.

I will now turn the call over to Travis Stice.

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**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

Thank you, Adam, and good morning, everyone, and thank you for joining the call. I'm really excited to share with you that Diamondback has announced 2 strategic, highly accretive acquisitions in the Northern Midland Basin. The acquisition of all the leasehold interests and related assets of Guidon Operating and the acquisition of QEP Resources. These acquisitions check every box when it comes to Diamondback's corporate development strategy.

One, they're accretive. These deals are, both together and individually, accretive on all relevant 2021 financial metrics, including free cash flow per share, cash flow per share and leverage, even before accounting for synergies.

This accretion only increases over time as the pro forma high-graded development plan will result in more free cash flow, and therefore, return of capital per share than the already strong stand-alone plan.

Two, the assets compete for capital. These deals add Tier 1 resource that competes for capital wide away in Diamondback's current portfolio. Upon closing, we will reallocate capital from our existing assets to high-grade development and accelerate activity on these assets, which is the definition of good capital allocation.

Three, these deals improve our capital efficiency. We will now be able to allocate more of our capital to the high-returning Midland Basin, where our cost structure and asset base remains differentiated. These deals improve 2021 capital efficiency, lower our near and long-term reinvestment ratio and lower our 2021 breakeven because of the quality of the acreage we are integrating into our portfolio.

Four, these deals are leverage accretive. Pro forma for these transactions, Diamondback is expected to maintain its investment grade status, ensuring access to capital. Over a multiyear time period, Diamondback will be able to retire pro forma debt faster than a stand-alone plan as a result of these transactions.

Fifth, the deals offer tangible, visible synergies. We estimate we can drive at least $60 million to $80 million of annual synergies, primarily through a combination of G&A and cost of capital synergies, with secondary synergies that include improved capital efficiency from high-graded development and physical adjacencies that will increase our pro forma lateral lengths.

QEP has done a great job building out their midstream infrastructure in the Permian, and there will be opportunities to consolidate that infrastructure with both Diamondback's and Rattler's existing systems in the future, allowing for more efficient development of midstream and infrastructure capital.

Also, all of QEP's oil production is dedicated to Rattler's joint venture gathering system with Oryx Midstream of which Rattler owns 60% of the JV.

And lastly, the sixth point, there's minimal integration risk. These assets are simply in our backyard, the Northern Midland Basin. Integrating these assets will present more opportunities than challenges due to the physical adjacencies to our existing position. The [blocky] nature of the pro forma position will provide for most capital-efficient development as possible.

As stated in the past public commentary, Diamondback does not need to participate in industry consolidation simply to get better. We participate in corporate development opportunities that we firmly believe will increase the long-term value of our stockholders' investment. These deals help cement Diamondback's leadership position in the northern Midland Basin which is why we're excited to discuss these 2 deals with you today.

With that, operator, please open the line for questions.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) And our first question comes from Neal Dingmann with Truist Securities.

**Neal David Dingmann** - *Truist Securities, Inc., Research Division - MD*

Travis, congrats. Travis, was just wondering how important was having a large equity component for these deals? And can you talk about how your estimate on just -- you talked about this a little bit in prepared remarks, but just again, you can go over a little bit again on your thoughts on leverage post these deals?

**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

Yes. Listen, Neal, as I highlighted, our ability did -- well, first off, leverage comes down with -- upon closing of these transition -- transactions. And even more importantly, the rate at which that leverage ratio continues to decrease is accelerated. So it's a win across the board when it comes to leverage.

**Neal David Dingmann** - *Truist Securities, Inc., Research Division - MD*

Got it. And then how do you think on these deals, on just, could you talk a little bit about how you guys assigned maybe for little bit on just the Bakken? And then I'm just trying to think on what you guys are looking at on kind of a per -- I know we've come up with that how you all are thinking on kind of a per acre basis? And what that ascribes to the -- does that include -- what on the PDPs? And then, what does that back out for the synergies?

**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

Yes. Let me first address your question on the Bakken. Diamondback is a pure play, and we've got no intention in diversifying away from what we think is the best remaining development opportunity in the Northern Basin, which, of course, is right here in the Permian Basin.

If you think about the Bakken assets, it's very similar to when we announced the Energen acquisition, and we had those assets on the Central Basin Platform that we just simply held for sale. And that's what we intend to do here once the deal closes and we get a chance to do some value propositions.

The second thing is that, you were talking about the quality of the acreage and how much -- what it was costing. And this acreage, Neal, we actually bid on back in 2015 and 2016. We know the acreage very well. We didn't get it back then. It went for $50,000 or $60,000 an acre back in the day. But if you do the math on these with $20,000, $25,000 per flowing barrel, you'll see that these per acreage acquisition costs are among the lowest that Diamondback has ever done. And in fact, these acquisitions probably rival when we bought Spanish Trail back in 2009.

**Operator**

Our next question comes from Gail Nicholson with Stephens.

**Gail Amanda Nicholson Dodds** - *Stephens Inc., Research Division - MD & Analyst*

When you guys are looking at the $60 million to $80 million per year of synergies, can you just break that out between how you're looking at that via CapEx synergies, expense synergies on the G&A side and maybe potentially, LOE as well as interest reduction synergies as you guys are investment-grade and QEP is not?

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**Matthew Kaes Van't Hof** - *Diamondback Energy, Inc. - CFO & Executive VP of Business Development*

Yes, Gail, I'd say the majority of the synergies come on the G&A side. And I think we are well staffed at Diamondback and have been patient throughout this year to add assets opportunistically and do so in a way where we don't have to add a lot of people or expense to that. So that's probably the majority of the synergies.

Obviously, interest cost savings will be important. Retaining investment-grade status was vital to us and to our Board and that ensures a lower cost of capital. I think, overall, we still want to be reducing net debt versus extending maturities, but we do have a lot of opportunities now to do both.

On top of that, LOE -- QEP is a great operator. They have a very low-cost structure. They think about the business in a similar way to us and therefore, have had a lot of infield infrastructure built. And I think, as you can see in the math, the physical adjacencies, it's going to allow for us to merge our systems together and utilize capacity effectively. So I think, long term, that drives LOE savings and certainly capital on the midstream and infrastructure side, but the most tangible synergies are on the G&A and the interest side.

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**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

Yes. And Gail, I know you've studied Diamondback for a long time, and you know that we operate a lean organization, and we're proud of that. And listen, even in the -- the fact of the global apocalypse we've endured through this catastrophic downturn. We've been able to avoid any layoffs, and we've retained the organizational capacity that we had prior to our downturn. And look, that G&A per barrel at around $0.50 a barrel what was then and is still now peer leading. And with the combination of these deals, that cost per barrel on G&A actually goes down. So it's -- and that's -- the LOE side is the field organization will stay in place, but that goes to LOE, not G&A. So we've shown in the past that we've got expertise in integrating new entities and, on a large scale, most recently with the Energen acquisition.

But as we think about this, this is more of a tuck-in operationally to our existing organization than really an entity integration. So very confident that we conservatively model synergies, and certainly, we'll continue to maintain our leadership position.

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**Gail Amanda Nicholson Dodds** - *Stephens Inc., Research Division - MD & Analyst*

Great. And then you've mentioned the idea of capital reallocation to these assets once they're put into the portfolio. Can you talk about where that reallocation occurred from? And then also in the presentation, you mentioned that this is going to be reducing your 2021 breakeven. Can you talk about where breakeven was in '21, and where breakeven will be close of the acquisition?

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**Matthew Kaes Van't Hof** - *Diamondback Energy, Inc. - CFO & Executive VP of Business Development*

Yes, Gail, we got to make sure these deals close and we come out with full pro forma guidance, but the way we're thinking about it, in general, is that, both QEP and Guidon have assets that compete in the top of our portfolio.

I think our base plan with Guidon was to reduce a rig or [1.5] at Diamondback and allocate to, to Guidon. And then when you add QEP on top of that, you run their kind of 2 rig cadence, but I think you can also reallocate some of our existing rigs to an area like Robertson Ranch which is in the dead center in Martin County and hasn't been getting capital from QEP yet to date. And so I think just, overall, pushing more of our capital, a higher percentage of our capital to the northern Midland Basin lowers that reinvestment ratio and the breakeven.

And I think, overall, our plan is to, basically, hold pro forma Q4 2020 production flat. And I think we're going to be able to do that with less dollars per BO added or BO maintained than we were prior.

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**Operator**

Our next question comes from Arun Jayaram with JPMorgan Chase.

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**Arun Jayaram** - *JPMorgan Chase & Co, Research Division - Senior Equity Research Analyst*

Kaes, I wanted to see if you could talk about any plans that you have to leverage Diamondback's, IG, credit rating and lower cost of capital. As you know, QEP has about $1.1 billion of debt due before May 2023. So where are you heading in terms of thinking about those bond maturities in '22 and '23?

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**Matthew Kaes Van't Hof** - *Diamondback Energy, Inc. - CFO & Executive VP of Business Development*

Yes, Arun, that was an important part of this trade. And I think, overall, we modeled the business where we could pay those off with cash and free cash flow, between now and that time period. I don't think that's going to be the case. I think we'll probably do some form of liability management that involves the defining 21s and the -- the QEP 22s and 23s and also defining 25s that are callable. So I think we kept that bond out there for an opportunity to refinance, and we have a lot of options at our disposal here. I think, overall, some combination of extending maturities, but also, paying down gross debt is our game plan.

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**Arun Jayaram** - *JPMorgan Chase & Co, Research Division - Senior Equity Research Analyst*

Great. Great. Secondly, Trace -- Kaes -- pardon me or Travis, it seems like high grading here is a -- one of the deal motivations here or deal rationale. Can you talk about, from a productivity basis, how the Guidon and QEP assets in the northern Midland Basin compete to things existing asset base in the Midland Basin.

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**Matthew Kaes Van't Hof** - *Diamondback Energy, Inc. - CFO & Executive VP of Business Development*

Yes. I think they compete in the top quartile of our existing northern Midland Basin acreage position. And I think, as Travis said, we've made public comments in the past that, we don't need to get bigger just to get bigger. We have to get better. And capital allocation and NAV, while they're not hot topics today in oil and gas, our ability to drill better wells for the next 5, 10 years versus our original plan is very important to our shareholders and very important to long-term value creation. Travis, do you want to add anything to add to that?

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**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

Yes, listen Arun, the way that we're thinking about it is that, the addition of these locations, this inventory that immediately competes for capital has now extended Diamondback's runway of Tier 1 inventory projects for more than a decade. Tier 1 being some kind of 30% or so rate of return at the current strip. So a lot of the questions we've heard in the past is, "Hey, Diamondback is a great operator. They've got best cost structure in the business. But their Tier 1 inventory is short." And we never have agreed with that proposition. But certainly, with the addition of these 2 acquisitions, we've extended that runway significantly.

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**Operator**

Our next question comes from Derrick Whitfield with Stifel.

**Derrick Lee Whitfield** - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD of E&P and Senior Analyst*

Congrats on the acquisition. Perhaps for Travis or Kaes, could you speak to the synergy opportunities from a Viper or Rattler perspective? I know you guys have focused on the G&A side of the equation. But seemingly, there's a lot of opportunities on the midstream side as well.

**Matthew Kaes Van't Hof** - *Diamondback Energy, Inc. - CFO & Executive VP of Business Development*

Yes, Derrick, we obviously looked at that in detail. And QEP, like I said earlier in the call, has really thought about their development in a similar fashion to Diamondback, and that's controlling more midstream and also keeping those costs in-house. So I do think there's a good amount of midstream value on the QEP side that Rattler will have a chance to take a look at.

And then on top of that, like Travis said, all of QEP's oil production flows through the Reliance -- former Reliance gathering system, which now is called the OMOG JV that Rattler owns 60%, Oryx own 40%. And part of the reason why we bought that deal back in the day was understanding the underlying quality of the acreage that's on that system. And that's proven out to be a good investment that's now going to look a little better with more capital being allocated to pro forma OMOG acreage.

On the Viper side, we actually don't own a lot of minerals underneath QEP or Guidon today, but I think that opens up a new sandbox for our Viper team to increase mineral ownership under Diamondback properties. There's some significant ranches and mineral owners under both. And I think we look forward to having those conversations on the Viper side.

**Derrick Lee Whitfield** - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD of E&P and Senior Analyst*

Great. And perhaps for Travis, as you compare and contrast your operations, with QEP, what's your early assessment on QEP's development approach via tank-style development?

**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

Yes. We're going to -- Derrick, that's a great question. And we're going to be widening that development spacing. And that's what we have in our go-forward development plan. So the fewer wells but greater productivity per well.

**Matthew Kaes Van't Hof** - *Diamondback Energy, Inc. - CFO & Executive VP of Business Development*

Yes. We agree with the tank-style, right? It's just a matter of spacing. And I think, when we looked at both of these deals, we're very conservative on spacing. And we're also very conservative on development pace. Gone are the days of, acquire, exploit and accelerate. I think we're now talking acquire, exploit high-grade and distributed cash. And that means you're not ramping the rig count on your acquisitions like deals of the past.

**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

Yes. And listen, high grading -- we've had several questions now on the high grading of these assets. And that is important. But the primary reason that we did these deals, as I highlighted in my opening comments is that we are now improving cash flow, earnings efficiency, the leverage targets, all of those things with the announcements of these deals. And it's our responsibility to work through development plans upon close in a way that drives the most return and greatest net present value.

**Operator**

Our next question comes from David Deckelbaum with Cowen.

**David Adam Deckelbaum** - *Cowen and Company, LLC, Research Division - MD & Senior Analyst*

Just curious, why we have the third [gilding] get across the finish line this morning?

**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

Well, this one, listen, David, I'll tell you that we can't determine the circumstances or the timing at which we find opportunities 1, 2 or 3 in your question. But we just simply have to evaluate them as they unfold. And in my experience of doing this for over 35 years now, it's not uncommon to find extraordinary opportunities in times of tremendous pressure, such as we have now, but you've got to be ready for them, right? Organizationally, you have to be ready for them.

And the simple fact is that, we believe each of these opportunities adds the value individually to our shareholders. That they happen at the same time, that's just coincidence. We're fortunate enough, even though there's some tired eyes around the conference table in here to have the organizational capacity to do that heavy lifting and evaluating these opportunities. And also we've got the bandwidth to integrate in both. So the fact that it's 2, not 3, it's just a function of coincidence.

**David Adam Deckelbaum** - *Cowen and Company, LLC, Research Division - MD & Senior Analyst*

I appreciate that. So my first question just is on well costs. If we're looking at QEP's stated well cost per lateral foot in the 400s now, Diamondback's, Midland, obviously a bit above that. If we're comparing them apples-to-apples, is that more due to QEP's infrastructure in place? Or do you feel like there's some headway to be made? Or should we see those costs kind of fit more to the Diamondback completion style?

**Matthew Kaes Van't Hof** - *Diamondback Energy, Inc. - CFO & Executive VP of Business Development*

Yes, David, like I said, a couple of questions ago, QEP is a very good operator, and we've learned a lot from their development in Martin County. We use now simul frac crews on all of our Midland Basin development, and they were an early adopter of that.

I will say, from a D&C perspective, we're very, very close. I think their stated number was 430 a foot last quarter, and ours is about 450. We include the equip in ours. So that puts our Midland Basin well cost at 530 a foot. I'd say overall, both companies are low-cost operators. We tend to do a little bit bigger frac job, which is probably a little bit of a difference in well costs, and therefore, little wider spacing, with a little higher, bigger frac job is probably going to result in a little more productivity per well completed.

**David Adam Deckelbaum** - *Cowen and Company, LLC, Research Division - MD & Senior Analyst*

I appreciate that. And just a last one from me. I know there isn't formal guidance out there yet. But should we still be generally thinking about that sort of 30% reduction in total spend versus 2020 next year to keep that fourth quarter number flat?

**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

No. That's going to be tough to do when you're adding 50,000 barrels a day that are going to decline. So we're going to have to spend more than what the original plan was for Diamondback stand-alone. I think, overall, it's going to look more capital-efficient than, if you stack the 3 businesses on top of each other. But we're going to pull that information together and update the market as quickly as we can.

**Operator**

Our next question comes from Asit Sen with Bank of America.

**Asit Kumar Sen** - *BofA Merrill Lynch, Research Division - Research Analyst*

Expectations for 2021 production remains unchanged, which is great, Travis. And congratulations and the true to which you have said in the past. My question is, what could prompt any change on that guidance in 2021? And how should we think conceptually about production growth into 2022?

**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

Well, certainly, Asit, there are no indications today that the market needs more oil. There should be no growth in our sector at all. We've got a world that's still 6 million to 7 million barrels a day oversupplied. We've got a world that's still vitally struggling with what the economies are going to look like post COVID. So there's just no reason or call for production growth in 2021. I think most experts, of which I am not, are more optimistic about the back half of 2021.

And look, the future plan for Diamondback, which was certainly not issuing multiyear guidance, but should the market, again call for a small growth rate in the future 2022 or beyond, Diamondback's ability to do so now more efficiently has been increased with the addition of these high-quality assets.

**Asit Kumar Sen** - *BofA Merrill Lynch, Research Division - Research Analyst*

Great, Travis. In your opening commentary, again, a similar theme. You mentioned transaction lowers 2021 reinvestment ratio. Could you speak to, directionally, how much? And when do you think broadly about the business looking into 2022, how are you thinking about reinvestment rates?

**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

Yes. I mean, I think just generally about strip, which today is probably going to be a little lower, but strip as of Friday, we're talking about a sub 60-ish percent reinvestment ratio in '21. I don't think we'll be able to retain that forever, but I do think we have a business that can generate consistent free cash flow and distribute that free cash flow to shareholders in an investment-grade balance sheet for a much longer period of time now.

**Matthew Kaes Van't Hof** - *Diamondback Energy, Inc. - CFO & Executive VP of Business Development*

Yes. Just to add to that, QEP has a few DUCs or a good amount of DUCs as does Diamondback. And so I think that's going to help 2021 from a capital efficiency perspective. I think when we get our hands on development at both assets and drill some good wells with a little wider spacing, you will be having less wells completed in 2022 to require the same amount of production stability.

**Operator**

Our next question comes from Nitin Kumar with Wells Fargo.

**Nitin Kumar** - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Maybe just kind of following up on that high-grading concept, Travis. The last quarter, you had reported roughly 3,300 locations in the Midland, breakeven below 35. QEP, as you mentioned earlier, had gone through a slightly tighter spacing and a different development strategy.

As a percentage, or directionally, how much more inventory should we be thinking about from this deal?

**Matthew Kaes Van't Hof** - *Diamondback Energy, Inc. - CFO & Executive VP of Business Development*

Yes. It's probably somewhere about 1/3 of that that's highly economic and competes in the top quartile of our pro forma portfolio.

**Nitin Kumar** - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Okay. And is that, when you say 1/3 of, that's 1/3 of [3,300]?

**Matthew Kaes Van't Hof** - *Diamondback Energy, Inc. - CFO & Executive VP of Business Development*

Yes, that's correct.

**Nitin Kumar** - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Okay. What's -- do you have a sense of what the decline rate was for both Guidon and QEP in the Permian compared to yours?

**Matthew Kaes Van't Hof** - *Diamondback Energy, Inc. - CFO & Executive VP of Business Development*

QEP's are very similar to ours. They've been around developing for a while, similar production basis. I think their corporate decline was a little lighter than ours because of the Bakken. But Guidon probably has a little higher corporate decline, but the total production that you're contributing on the Guidon side is less than the QEP side. So I'd say, Guidon, a ton of economic inventory ahead of it, with early in its production life cycle. And QEP, obviously has been public. So everyone knows what their production has been for a long time, but there's a lot of completely undeveloped rock at both companies.

**Nitin Kumar** - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

And if I could just sneak one more in. QEP had some DUCs in the Bakken. You've classified those asset as more of a noncore asset. Does that mean that you wouldn't be pursuing those opportunities at all? Or how should we think about those?

**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

Yes, that's correct. I mean those will sit there, but they have some value.

**Operator**

Our next question comes from Harry Mateer with Barclays.

**Harry Mead Mateer** - *Barclays Bank PLC, Research Division - Head of Global Energy Credit Research & Co-Head of US Investment Grade Research*

I appreciate the comments earlier about how you're thinking about the pro forma cap structure, combo liability management and then, still with some gross debt reduction. I'm curious, how do you plan to treat the QEP bonds and the pro forma structure? Are you guys going to allow for some structural subordination? Or is the preference to have it more be clean, [carry], pursue potential of cross guarantees or some kind of like kind of exchange in defining notes?

**Matthew Kaes Van't Hof** - *Diamondback Energy, Inc. - CFO & Executive VP of Business Development*

Yes. There's going to be no guarantee. We did the same strategy with the Energen bond, so that they're going to fit -- the QEP's bonds will fit in the merger sub. And will not be guaranteed by the guarantor group. Now most likely, we're going to be focused on the 22s and 23s. So that probably leads to 26s sitting in that group for a longer period of time. But I think overall, like we said at the beginning of the call, we do have a lot of flexibility with a Diamondback 2025 bond that's callable, and the 22s and 23s as kind of our chess pieces for liability management.

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**Operator**

Our next question comes from Charles Meade with Johnson Rice.

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**Charles Arthur Meade** - *Johnson Rice & Company, L.L.C., Research Division - Analyst*

Travis, I want to go back to your earlier comments. In that, I think, it's good that you -- I guess your opening comments, were you really focused on leverage? And frankly, as you would guess, I have to do more work to put these pieces together and see how it all -- see how it flows. But it looks to me like numbers, you're going to be approaching, you're 2x at year-end '21 on a net debt-to-EBITDA basis. It looks to me that with the -- obviously, the Guidon stuff is coming, the cash consideration, that's going to be below 2x, but the QEP was coming in. It looks like something north of 3x. And so I want to just make sure I'm understanding what you were saying. It looks to me, with just our cursory look, that you guys are going to be more levered than you otherwise would have been at year-end '21, but I just want to just go back and -- but in both cases, you will be delevering over time. So I just wanted to check and make sure I understood your pieces there.

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**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

Yes, that's completely incorrect, Charles. We're going to be below on a pro forma basis, where we were stand-alone. So I think, immediately, Q2 2021, we put these 2 businesses together -- or 3 businesses together, you're 4% or 5% below the stand-alone plan, and that's run at the same strip. And then you accelerate that deleveraging faster in the pro forma business than stand-alone. So I think, overall, it's not a huge number, but we're still anticipating being close to 2x at strip with both businesses integrated.

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**Charles Arthur Meade** - *Johnson Rice & Company, L.L.C., Research Division - Analyst*

Okay. Just to be clear, when you say, whatever, 4%, 5% level, you're talking on a metric or a multiple basis, not on an absolute basis?

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**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

That's correct. I mean the size of the enterprise value just got significantly higher.

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**Charles Arthur Meade** - *Johnson Rice & Company, L.L.C., Research Division - Analyst*

Right. Yes. That makes sense. I just want to be clear. And then the question I have going back to these assets you picked up in Southeast Martin. To me, that looks like that new or the additions in the Southeast Martin is probably going to be up to some of that top quartile stuff. Can you give us a sense for these -- for the new acreage you brought in, what percent developed is that in that Southeast Martin quadrant?

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**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

Yes. That's -- on the QEP side in Southeast Martin, that's the Robinson Ranch and they have not developed that at all. So I think that's going to be a very exciting development area for us. Guidon has a couple wells offset that to the southwest. But I would say that block is less than 10% developed. So that's going to be a very important area for us on -- from an oil production perspective and a capital efficiency perspective.







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**Operator**

Our next question comes from Brian Singer with Goldman Sachs.

**Brian Arthur Singer** - *Goldman Sachs Group, Inc., Research Division - MD & Senior Equity Research Analyst*

Wanted to follow-up first on the capital allocation. You've maintained your dividend despite the volatility in the markets this year. And you've highlighted the pro forma leverage coming down and maintaining investment grade. Can you talk to what you'd be looking for leverage wise to allocate more capital to shareholders via dividend or repurchase?

Or how if at all the transactions that you're announcing today changes your strategy there?

**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

Well, we're not changing our strategy with these acquisitions. I mean I've talked about how these -- both of these trades are accretive across all fronts. In fact, our development strategy hasn't changed. It's just gotten better. So we've always talked, it's not an either/or above debt reduction and a dividend increase. It's an, and. And there's beauty in that as well because, we believe that with the addition of these assets, we can both continue to lean into the dividend and as Kaes has been talking about, the market's true to really lower our leverage ratio.

**Brian Arthur Singer** - *Goldman Sachs Group, Inc., Research Division - MD & Senior Equity Research Analyst*

Great. And is there a certain point at which -- and I realize that you say it's an, and, not an, or, but is there certain point of sub 2 or sub of 1.7 or sub 1.5, kind of where you want to take this?

**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

It really just depends on the outlook, Brian. I think there's still a lot of uncertainty in the market, particularly in the first half of next year. So our Board has traditionally looked at the dividend in the first quarter to address it.

This year, we stayed patient and held it flat. After doubling it a month before the Saudi price war and COVID breakout. But overall, I mean, I think we can take a look at it by kind of the middle of next year. Because, overall, the amount of free cash flow -- a dividend increase on the amount of free cash flow that we're talking about does not impact our ability to generate free cash and reduce the enterprise value through a combination of debt reduction and then continuing the shareholder return on the dividend side.

**Brian Arthur Singer** - *Goldman Sachs Group, Inc., Research Division - MD & Senior Equity Research Analyst*

Great. And then my final question is with regards to the capital reallocation. We spent a lot of time here talking understandably about the attractive assets in the northern Midland Basin and treating the Bakken and the Williston Basin assets as noncore and potentially candidates for asset sales.

Can you talk a little bit about the implications for the Delaware Basin? It seems like there's a capital allocation away -- potentially away from the Delaware? And just how you think about the strategic role of the Delaware assets in a pro forma portfolio?

**Matthew Kaes Van't Hof** - *Diamondback Energy, Inc. - CFO & Executive VP of Business Development*

Yes. Certainly, the Delaware is still important to us, and there are locations there that compete for capital in the portfolio. I think, overall, we're excited that we can allocate a higher percentage of our capital for the Midland Basin. I would just say that the well results generally tend to be better on a returns basis. But also our cost structure is better, overall, as well.

So there's still a lot of Delaware acreage that competes for capital in our existing portfolio. But I would just say, it's become less important to the overall company than the northern Midland Basin, which is kind of our home and where we got started.

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**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

Yes. But listen, Brian, I completely agree with what Kaes is saying. But I just want to get -- just want to make sure you understand how proud that I am of our organization's ability to continue to improve results in the Delaware Basin, since we acquired that back in 2016.

In terms of rate of change of improvement, the Delaware Basin has been a remarkable success story for Diamondback. As Kaes pointed out, as commodity prices got lower and increased focus on total rate of return, it forced us, as good capital allocators, to allocate towards higher rate of return. But in no way, shape, form or fashion do we need to imply that the Delaware Basin is not as important to us nor the organization that's running that Delaware Basin hasn't done a good job because it's quite the opposite.

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**Operator**

Our next question comes from David Heikkinen with Heikkinen Energy.

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**David Martin Heikkinen** - *Heikkinen Energy Advisors, LLC - Founding Partner and CEO*

We know a lot about your assets in QEP. Can you talk a little bit about the history of Guidon just what their pace of development has been? You hit a little bit of their decline rates are a little steeper. But and they have the 8 DUCs that you had in the press releases. But can you talk to us a little bit about where Guidon was, what their activity level had been pre maybe, first quarter level, before everything became a half-half, glass of empty kind of world. And then just have one follow-up.

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**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

Yes. Well, today, this is the day, we're going to start with the glass half full commentary. So 2020 is in almost in the rearview, 10 days left. But overall, listen, they've been around for a while. They acquired their assets from Endeavor in 2016. A great timely purchase. And they've been a pretty active developer of -- with 1 or 2 rigs for the last couple of years. Obviously, things slowed down a little bit with the glass-half-empty portion of the year. And now I think they've been running 1 rig pretty consistently for the last 6 months or so and completing pretty large pads. And we got some nice-looking pads on the schedule in the first half of the year, and we're looking forward to adding kind of another rig to that development plan to keep things moving, particularly in the Southeast Martin County portion.

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**David Martin Heikkinen** - *Heikkinen Energy Advisors, LLC - Founding Partner and CEO*

And did they have any hedges by chance?

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**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

We're not taking on any hedges. It's an asset deal. But we will take on all the QEP hedges.

**David Martin Heikkinen** - *Heikkinen Energy Advisors, LLC - Founding Partner and CEO*

Helpful. And on the half full side, couldn't agree more. And hopefully, our note was a little more half empty than I intended on rereading it. So looks accretive to us on deals and have a merry Christmas and a happy new Year and look forward to actually seeing people, again, hopefully, in 2021. So have a great holiday season.

**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

Yes. Thanks, David. Appreciate it.

**Operator**

Our next question comes from Jeoffrey Lambujon with Tudor, Pickering, Holt.

**Jeoffrey Restituto Lambujon** - *Tudor, Pickering, Holt & Co. Securities, LLC, Research Division - Director of Exploration and Production Research*

I'll talk before about the scale of the legacy Diamondback portfolio of being sufficient to compete for these deals. These transactions, obviously, we build on that. So as you look at the pro forma position on acreage and production and also what the opportunity set still is, it cost a bit under the Delaware today, how are you thinking about treating other opportunities from here? I apologize, if I missed this earlier, but maybe you can just speak to how these transactions came together and how Diamondback activity in the market would change, if at all, as these deals close?

**Matthew Kaes Van't Hof** - *Diamondback Energy, Inc. - CFO & Executive VP of Business Development*

Yes, Jeff, I saw your note this morning, too. And I think our commentary is firmly that, when we get bigger, we have to get better. And this acreage makes us better. It competes for capital right away. And I think we've belabored that point in us. But overall, going into this year, our[BD] team has done an incredible job. We've had, basically, NAVs built for almost every target that we're interested in, both private and public. And it's just a matter of timing. And fortunately, for us, the rally of a last couple of months has allowed us to have real conversations and get a deal done. It's -- or 2 deals done. We didn't want that happen at the same time. But I think overall, these were our 2 top targets from acreage quality perspective, going into the year, and the year took us a much different path than we all expected. But we ended up acquiring the 2 targets that we had highest on our list.

**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

Yes. Jeoffrey, just let me emphasize the point that I made earlier about, we can't control the timing of opportunity, nor the circumstances. But what we can control is our ability, organizationally, to be prepared. While 2020 certainly will be marked by the wailing and gnashing of teeth and wringing of hands, as Kaes pointed, our business development team doubled down and tripled down on their efforts to provide us a full economic workup on all of the assets that we were interested in, even though, we knew that, for much of 2020, we were going to be unable to execute on those.

So again, you -- as I mentioned, these trying times can present great opportunities for companies that are prepared, and we're giving you a great example of a company that was prepared this morning.

**Operator**

Our next question comes from Leo Mariani with KeyBanc.

**Leo Paul Mariani** - *KeyBanc Capital Markets Inc., Research Division - Analyst*

Just wanted to touch base a bit on sort of the liability management side, which you guys mentioned here. Obviously, you're all taking on more absolute debt as we roll into 2021 here. And you guys mentioned that, and you think it's still a bit of an uncertain outlook out there, at least the portions of '21? Would you plan on kind of hedging more portions of these volumes, maybe in '21 to try to kind of lock in some of the cash flows on these deals? Is that something else that you think you'll be working on here as these deals start to look like that they're going to close?

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**Matthew Kaes Van't Hof** - *Diamondback Energy, Inc. - CFO & Executive VP of Business Development*

Yes, Leo, that's a good question. I think hedging needs to become a bigger part of our strategy irrespective of our debt levels. I think investors want returns on capital and guaranteed return of capital. And in our business, the only way to protect that is to protect your revenue stream. So we are almost 80% hedged in Q1. And then you roll in these 2 deals. In Q2, we're about 2/3 hedged, and that tails off a little bit in the back half of the year. But basically, we're putting in place a business that can lock in returns and also lock in a combination of debt reduction plus the dividend.

So the way we modeled it, kind of at $45 flat, which is where the curve has been recently, we're able to handle every note as far when they come due. Again, I don't think that's what we're planning on doing, but that did give us, and our Board, a lot of sense of security that we have protection.

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**Leo Paul Mariani** - *KeyBanc Capital Markets Inc., Research Division - Analyst*

Okay. That's helpful for sure. And just kind of looking at the value propositions in terms of kind of purchase price for these 2 assets. It certainly looked like you guys paid a little bit more in terms of I guess, production value pro forma believed for Guidon versus QEP here. Is there some other features, anything that we should be kind of bringing into that? Do you need to see the Guidon assets maybe is a little bit better. And obviously, with QEP ahead of Bakken, I guess, a lot more debt. Does it maybe more just -- difference was more just a capital structure with a lot of additional debt coming from the QEP's side? Want to get a sense of any kind of value proposition differences that you looked at for these 2 deals?

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**Matthew Kaes Van't Hof** - *Diamondback Energy, Inc. - CFO & Executive VP of Business Development*

Yes. Well, they're completely different deals, right? On the private side, you look at your NAV and drill out with a couple of rigs for all of the inventory on Guidon and present value of those cash flows. And coincidentally, that's the number that we were comfortable paying on a multiple basis in the near term. And it's quite the opposite on the QEP side, because you do have a public currency and so relative valuation and looking at where they're trading and what their enterprise value versus what we could pay for it. Those are 2 different scenarios.

So I think dollar per flowing is an output not an input. And, overall, I think, our internal NAV with and without synergies for QEP was well above the market price as of Friday.

And on the Guidon side, I think the counter party sees a lot of value in Diamondback's stock and therefore, was happy taking a good amount of stock in the trade.

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**Operator**

Our next question comes from Jeanine Wai with Barclays.

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**Jeanine Wai** - *Barclays Bank PLC, Research Division - Research Analyst*

My first question is just a follow-up on Brian's question on the Delaware. I know you said that the basin will remain important to FANG, but are there parts of that acreage that may qualify as a potential divestiture candidate, maybe a little bit down the line?

**Matthew Kaes Van't Hof** - *Diamondback Energy, Inc. - CFO & Executive VP of Business Development*

I wouldn't say the Delaware -- it sits in the divestiture candidate box today. I mean, maybe some non-op stuff in the Delaware in New Mexico, in particular, because we're just not a big operator there. But I think, overall, our job is going to be looking at our whole asset base. And I think we do have some acreage that makes sense to sell. Travis mentioned the Bakken and also maybe, some stuff in the Southern Midland Basin, where you just have kind of PDP value. But our strategy throughout this year has been, if cash flow is cheap, we can't sell cash flow when it's cheaper. So I think there will be sale candidates, particularly as we get a more supportive strip. There's a lot of PDP buyers out there, I know that, that seems to be a very common private equity strategy this year. And so I think there's going to be a competitive process for some of these assets.

**Jeanine Wai** - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. Great. That's very helpful. And my second question is just on integration. So in terms of just generally managing integration risk, are there any lessons learned from the Energen deal that maybe you can apply to these 2 deals?

**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

Yes. You always want to learn from your prior experiences. But, Jeanine, I don't want to overplay the integration issue. These are simply -- they're tuck-ins for us. And the field organization is going to largely stay in place, integrating inside Diamondback's field organization, which is, as you can see on the map, it's contiguous. And this is just simply, Jeanine, what it is that we do? We integrate assets, and this one is no different than any other of the ones that we've demonstrated in the past that we're capable of doing.

**Operator**

And I'm showing no further questions. I'd like to turn the call back to Travis Stice, CEO, for any closing remarks.

**Travis D. Stice** - *Diamondback Energy, Inc. - CEO & Director*

Thank you. Just as we kind of close this out, I want to reiterate that every time the Diamondback completes a trade, it's objectively obvious that the shareholders are better off after the trade than before. If that isn't the case, then we simply don't do the trade. In both of the trades that we talked about this morning, Diamondback's shareholders are better off. They're better off because on every relevant financial measure you see significant accretion, and, in some cases, double digit accretion. These are certainly extraordinary times, but also times that create extraordinary opportunities for those, as I've mentioned before, that are prepared, and we are.

And we couldn't be more excited to bring these opportunities to our shareholders. Happy holidays. Merry Christmas to everyone out there. Stay well and God bless.

**Operator**

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect. Everyone, have a great day.