Diamondback Energy, Inc.
Form 10-Q
May 05, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

ýQUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED March 31, 2016
OR
oTRANSITION REPORT UNDER SECTION 13 OR 15(d) OF SECURITIES EXCHANGE ACT OF 1934
Commission File Number 001-35700

Diamondback Energy, Inc.
(Exact Name of Registrant As Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	45-4502447 (IRS Employer Identification Number)
500 West Texas, Suite 1200 Midland, Texas (Address of Principal Executive Offices)	79701 (Zip Code)

(432) 221-7400
(Registrant Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check One):
Large Accelerated Filer ý Accelerated Filer o

Non-Accelerated Filer o Smaller Reporting Company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý

As of April 29, 2016, 71,702,583 shares of the registrant’s common stock were outstanding.

DIAMONDBACK ENERGY, INC
FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2016
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GLOSSARY OF OIL AND NATURAL GAS TERMS

The following is a glossary of certain oil and gas terms that are used in this Quarterly Report on Form 10-Q (this "report"):

Basin	A large depression on the earth's surface in which sediments accumulate.
Bbl	Stock tank barrel, or 42 U.S. gallons liquid volume, used in this report in reference to crude oil or other liquid hydrocarbons.
Bbls/d	Bbls per day.
BOE	Barrels of oil equivalent, with six thousand cubic feet of natural gas being equivalent to one barrel of oil.
BOE/d	BOE per day.
British Thermal Unit	The quantity of heat required to raise the temperature of one pound of water by one degree Fahrenheit.
Completion	The process of treating a drilled well followed by the installation of permanent equipment for the production of natural gas or oil, or in the case of a dry hole, the reporting of abandonment to the appropriate agency.
Condensate	Liquid hydrocarbons associated with the production of a primarily natural gas reserve.
Crude oil	Liquid hydrocarbons retrieved from geological structures underground to be refined into fuel sources.
Finding and development costs	Capital costs incurred in the acquisition, exploitation and exploration of proved oil and natural gas reserves divided by proved reserve additions and revisions to proved reserves.
Gross acres or gross wells	The total acres or wells, as the case may be, in which a working interest is owned.
Horizontal drilling	A drilling technique used in certain formations where a well is drilled vertically to a certain depth and then drilled at a right angle with a specified interval.
Horizontal wells	Wells drilled directionally horizontal to allow for development of structures not reachable through traditional vertical drilling mechanisms.
Mcf	Thousand cubic feet of natural gas.
Mcf/d	Mcf per day.
Mineral interests	The interests in ownership of the resource and mineral rights, giving an owner the right to profit from the extracted resources.
MMBtu	Million British Thermal Units.
Net acres or net wells	The sum of the fractional working interest owned in gross acres.
Oil and natural gas properties	Tracts of land consisting of properties to be developed for oil and natural gas resource extraction.
Play	A set of discovered or prospective oil and/or natural gas accumulations sharing similar geologic, geographic and temporal properties, such as source rock, reservoir structure, timing, trapping mechanism and hydrocarbon type.
Plugging and abandonment	Refers to the sealing off of fluids in the strata penetrated by a well so that the fluids from one stratum will not escape into another or to the surface. Regulations of all states require plugging of abandoned wells.
Prospect	A specific geographic area which, based on supporting geological, geophysical or other data and also preliminary economic analysis using reasonably anticipated prices and costs, is deemed to have potential for the discovery of commercial hydrocarbons.
Proved reserves	The estimated quantities of oil, natural gas and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be commercially recoverable in future years from known reservoirs under existing economic and operating conditions.
Reserves	Reserves are estimated remaining quantities of oil and natural gas and related substances anticipated to be economically producible, as of a given date, by application of development projects to known

accumulations. In addition, there must exist, or there must be a reasonable expectation that there will exist, the legal right to produce or a revenue interest in the production, installed means of delivering oil and natural gas or related substances to the market and all permits and financing required to implement the project. Reserves should not be assigned to adjacent reservoirs isolated by major, potentially sealing, faults until those reservoirs are penetrated and evaluated as economically producible. Reserves should not be assigned to areas that are clearly separated from a known accumulation by a non-productive reservoir (i.e., absence of reservoir, structurally low reservoir or negative test results). Such areas may contain prospective resources (i.e., potentially recoverable resources from undiscovered accumulations).

Reservoir	A porous and permeable underground formation containing a natural accumulation of producible natural gas and/or oil that is confined by impermeable rock or water barriers and is separate from other reservoirs.
Royalty interest	An interest that gives an owner the right to receive a portion of the resources or revenues without having to carry any costs of development.
Spacing	The distance between wells producing from the same reservoir. Spacing is often expressed in terms of acres (e.g., 40-acre spacing) and is often established by regulatory agencies.
Working interest	An operating interest that gives the owner the right to drill, produce and conduct operating activities on the property and receive a share of production and requires the owner to pay a share of the costs of drilling and production operations.

GLOSSARY OF CERTAIN OTHER TERMS

The following is a glossary of certain other terms that are used in this report.

2012 Plan	The Company's 2012 Equity Incentive Plan.
Company	Diamondback Energy, Inc., a Delaware corporation.
Exchange Act	The Securities Exchange Act of 1934, as amended.
GAAP	Accounting principles generally accepted in the United States.
General Partner	Viper Energy Partners GP LLC, a Delaware limited liability company and the General Partner of the Partnership.
Indenture	The indenture relating to the Senior Notes, dated as of September 18, 2013, among the Company, the subsidiary guarantors party thereto and Wells Fargo, as the trustee, as supplemented.
NYMEX	New York Mercantile Exchange.
Partnership	Viper Energy Partners LP, a Delaware limited partnership.
Partnership agreement	The first amended and restated agreement of limited partnership, dated June 23, 2014, entered into by the General Partner and Diamondback in connection with the closing of the Viper Offering.
SEC	Securities and Exchange Commission.
Securities Act	The Securities Act of 1933, as amended.
Senior Notes	The Company's 7.625% senior unsecured notes due 2021 in the aggregate principal amount of $450 million.
Viper LTIP	Viper Energy Partners LP Long Term Incentive Plan.
Viper Offering	The Partnerships' initial public offering.
Wells Fargo	Wells Fargo Bank, National Association.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Various statements contained in this report that express a belief, expectation, or intention, or that are not statements of historical fact, are forward-looking statements within the meaning of Section 27A of the Securities Act, and Section 21E of the Exchange Act. These forward-looking statements are subject to a number of risks and uncertainties, many of which are beyond our control. All statements, other than statements of historical fact, regarding our strategy, future operations, financial position, estimated revenues and losses, projected costs, prospects, plans and objectives of management are forward-looking statements. When used in this report, the words “could,” “believe,” “anticipate,” “intend,” “estimate,” “expect,” “may,” “continue,” “predict,” “potential,” “project” and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain such identifying words. In particular, the factors discussed in this report and detailed under Part II, Item 1A. Risk Factors in this report and our Annual Report on Form 10–K for the year ended December 31, 2015 could affect our actual results and cause our actual results to differ materially from expectations, estimates or assumptions expressed, forecasted or implied in such forward-looking statements.

Forward-looking statements may include statements about our:

- business strategy;
- exploration and development drilling prospects, inventories, projects and programs;
- oil and natural gas reserves;
- acquisitions;
- identified drilling locations;
- ability to obtain permits and governmental approvals;
- technology;
- financial strategy;
- realized oil and natural gas prices;
- production;
- lease operating expenses, general and administrative costs and finding and development costs;
- future operating results; and
- plans, objectives, expectations and intentions.

All forward-looking statements speak only as of the date of this report or, if earlier, as of the date they were made. We do not intend to, and disclaim any obligation to, update or revise any forward-looking statements unless required by securities laws. You should not place undue reliance on these forward-looking statements. These forward-looking statements are subject to a number of risks, uncertainties and assumptions. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. Although we believe that our plans, intentions and expectations reflected in or suggested by the forward-looking statements we make in this report are reasonable, we can give no assurance that these plans, intentions or expectations will be achieved or occur, and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements.

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Diamondback Energy, Inc. and Subsidiaries
Consolidated Balance Sheets
(Unaudited)

	March 31, 2016	December 31, 2015
	(In thousands, except par values and share data)	
Assets		
Current assets:		
Cash and cash equivalents	$235,810	$20,115
Restricted cash	500	500
Accounts receivable:		
Joint interest and other	15,211	41,309
Oil and natural gas sales	32,289	36,004
Related party	1,564	1,591
Inventories	1,591	1,728
Derivative instruments	821	4,623
Prepaid expenses and other	3,278	2,875
Total current assets	291,064	108,745
Property and equipment:		
Oil and natural gas properties, based on the full cost method of accounting ($1,090,246 and $1,106,816 excluded from amortization at March 31, 2016 and December 31, 2015, respectively)	4,036,440	3,955,373
Pipeline and gas gathering assets	7,174	7,174
Other property and equipment	49,763	48,621
Accumulated depletion, depreciation, amortization and impairment	(1,485,931)	(1,413,543)
Net property and equipment	2,607,446	2,597,625
Derivative instruments	111	—
Other assets	44,338	44,349
Total assets	$2,942,959	$2,750,719
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable-trade	$7,131	$20,008
Accounts payable-related party	206	217
Accrued capital expenditures	36,291	59,937
Other accrued liabilities	50,074	44,293
Revenues and royalties payable	12,998	16,966
Total current liabilities	106,700	141,421
Long-term debt	485,641	487,807
Asset retirement obligations	13,562	12,518
Total liabilities	605,903	641,746
Commitments and contingencies (Note 14)		
Stockholders' equity:		
Common stock, $0.01 par value, 100,000,000 shares authorized, 71,697,750 issued and outstanding at March 31, 2016; 66,797,041 issued and outstanding at December 31, 2015	717	668

Additional paid-in capital	2,494,467	2,229,664
Accumulated deficit	(387,272)	(354,360)
Total Diamondback Energy, Inc. stockholders' equity	2,107,912	1,875,972
Noncontrolling interest	229,144	233,001
Total equity	2,337,056	2,108,973
Total liabilities and equity	$2,942,959	$2,750,719

See accompanying notes to combined consolidated financial statements.

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Diamondback Energy, Inc. and Subsidiaries
Consolidated Statements of Operations
(Unaudited)

	Three Months Ended March 31,	
	2016	2015
	(In thousands, except per share amounts)	
Revenues:		
Oil sales	$79,020	$92,916
Natural gas sales	4,022	4,348
Natural gas liquid sales	4,439	4,137
Total revenues	87,481	101,401
Costs and expenses:		
Lease operating expenses	18,223	22,456
Production and ad valorem taxes	7,962	8,395
Gathering and transportation	2,789	1,030
Depreciation, depletion and amortization	42,069	59,677
Impairment of oil and natural gas properties	30,816	—
General and administrative expenses (including non-cash equity-based compensation, net of capitalized amounts, of $8,350 and $4,924 for the three months ended March 31, 2016 and 2015, respectively)	12,979	8,236
Asset retirement obligation accretion expense	246	170
Total costs and expenses	115,084	99,964
Income (loss) from operations	(27,603)	1,437
Other income (expense):		
Interest income (expense)	(10,013)	(10,497)
Other income	563	515
Gain on derivative instruments, net	1,426	18,354
Total other income (expense), net	(8,024)	8,372
Income (loss) before income taxes	(35,627)	9,809
Provision for income taxes	—	3,370
Net income (loss)	(35,627)	6,439
Less: Net income (loss) attributable to noncontrolling interest	(2,715)	590
Net income (loss) attributable to Diamondback Energy, Inc.	$(32,912)	$5,849
Earnings per common share:		
Basic	$(0.46)	$0.10
Diluted	$(0.46)	$0.10
Weighted average common shares outstanding:		
Basic	71,026	58,386
Diluted	71,026	58,626

See accompanying notes to combined consolidated financial statements.

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Diamondback Energy, Inc. and Subsidiaries
Consolidated Statements of Stockholders' Equity
(Unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Non-Controlling Interest	Total
	(In thousands)					
Balance December 31, 2014	56,888	$ 569	$ 1,554,174	$ 196,268	$ 234,202	$ 1,985,213
Unit-based compensation	—	—	—	—	939	939
Stock-based compensation	—	—	6,125	—	—	6,125
Distribution to non-controlling interest	—	—	—	—	(2,315)	(2,315)
Common shares issued in public offering, net of offering costs	2,012	20	119,208	—	—	119,228
Exercise of stock options and vesting of restricted stock units	108	1	887	—	—	888
Net income	—	—	—	5,849	590	6,439
Balance March 31, 2015	59,008	$ 590	$ 1,680,394	$ 202,117	$ 233,416	$ 2,116,517
Balance December 31, 2015	66,797	$ 668	$ 2,229,664	$ (354,360)	$ 233,001	$ 2,108,973
Unit-based compensation	—	—	—	—	973	973
Distribution to non-controlling interest	—	—	—	—	(2,115)	(2,115)
Common shares issued in public offering, net of offering costs	4,600	46	254,293	—	—	254,339
Exercise of stock options and vesting of restricted stock units	301	3	10,510	—	—	10,513
Net loss	—	—	—	(32,912)	(2,715)	(35,627)
Balance March 31, 2016	71,698	$ 717	$ 2,494,467	$ (387,272)	$ 229,144	$ 2,337,056

See accompanying notes to combined consolidated financial statements.

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Diamondback Energy, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(Unaudited)

	Three Months Ended March 31, 2016	2015
	(In thousands)	
Cash flows from operating activities:		
Net income (loss)	$(35,627)	$6,439
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Provision for (benefit from) deferred income taxes	—	2,425
Impairment of oil and natural gas properties	30,816	—
Asset retirement obligation accretion expense	246	170
Depreciation, depletion, and amortization	42,069	59,677
Amortization of debt issuance costs	668	630
Change in fair value of derivative instruments	3,691	25,206
Equity-based compensation expense	8,350	4,924
Changes in operating assets and liabilities:		
Accounts receivable	23,439	7,005
Accounts receivable-related party	27	—
Inventories	137	(20)
Prepaid expenses and other	(530)	(237)
Accounts payable and accrued liabilities	(5,121)	(16,226)
Accounts payable and accrued liabilities-related party	(12)	14,128
Accrued interest	8,575	8,476
Revenues and royalties payable	(3,968)	(13,454)
Net cash provided by operating activities	72,760	99,143
Cash flows from investing activities:		
Additions to oil and natural gas properties	(86,169)	(144,397)
Additions to oil and natural gas properties-related party	(164)	(7,000)
Acquisition of royalty interests	(2,082)	—
Acquisition of leasehold interests	(16,923)	(2,000)
Purchase of other property and equipment	(1,142)	(158)
Proceeds from sale of assets	123	—
Equity investments	(800)	—
Net cash used in investing activities	(107,157)	(153,555)
Cash flows from financing activities:		
Proceeds from borrowings under credit facility	8,500	57,501
Repayment under credit facility	(11,000)	(119,422)
Debt issuance costs	(4)	(8)
Public offering costs	(179)	(194)
Proceeds from public offerings	254,518	119,422
Exercise of stock options	372	888
Distribution to non-controlling interest	(2,115)	(2,315)
Net cash provided by financing activities	250,092	55,872
Net increase (decrease) in cash and cash equivalents	215,695	1,460
Cash and cash equivalents at beginning of period	20,115	30,183
Cash and cash equivalents at end of period	$235,810	$31,643

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Diamondback Energy, Inc. and Subsidiaries
Consolidated Statements of Cash Flows - Continued
(Unaudited)

	Three Months Ended March 31,	
	2016	2015
	(In thousands)	
Supplemental disclosure of cash flow information:		
Interest paid, net of capitalized interest	$823	$1,389
Supplemental disclosure of non-cash transactions:		
Asset retirement obligation incurred	$132	$102
Asset retirement obligation revisions in estimated liability	$88	$78
Asset retirement obligation acquired	$796	$47
Change in accrued capital expenditures	$(23,646)	$(45,854)
Capitalized stock-based compensation	$2,764	$2,139

See accompanying notes to combined consolidated financial statements.

Diamondback Energy, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(Unaudited)

1. DESCRIPTION OF THE BUSINESS AND BASIS OF PRESENTATION

Organization and Description of the Business

Diamondback Energy, Inc. (“Diamondback” or the “Company”), together with its subsidiaries, is an independent oil and gas company currently focused on the acquisition, development, exploration and exploitation of unconventional, onshore oil and natural gas reserves in the Permian Basin in West Texas. Diamondback was incorporated in Delaware on December 30, 2011.

The wholly-owned subsidiaries of Diamondback, as of March 31, 2016, include Diamondback E&P LLC, a Delaware limited liability company, Diamondback O&G LLC, a Delaware limited liability company, Viper Energy Partners GP LLC, a Delaware limited liability company, and White Fang Energy LLC, a Delaware limited liability company. The consolidated subsidiaries include the wholly-owned subsidiaries as well as Viper Energy Partners LP, a Delaware limited partnership (the “Partnership”), and the Partnership’s wholly-owned subsidiary Viper Energy Partners LLC, a Delaware limited liability company.

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its subsidiaries after all significant intercompany balances and transactions have been eliminated upon consolidation.

The Partnership is consolidated in the financial statements of the Company. As of March 31, 2016, the Company owned approximately 88% of the common units of the Partnership and the Company’s wholly-owned subsidiary, Viper Energy Partners GP LLC, is the General Partner of the Partnership.

These financial statements have been prepared by the Company without audit, pursuant to the rules and regulations of the SEC. They reflect all adjustments that are, in the opinion of management, necessary for a fair statement of the results for interim periods, on a basis consistent with the annual audited financial statements. All such adjustments are of a normal recurring nature. Certain information, accounting policies and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been omitted pursuant to such rules and regulations, although the Company believes the disclosures are adequate to make the information presented not misleading. This Quarterly Report on Form 10–Q should be read in conjunction with the Company’s most recent Annual Report on Form 10–K for the fiscal year ended December 31, 2015, which contains a summary of the Company’s significant accounting policies and other disclosures.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

Certain amounts included in or affecting the Company’s consolidated financial statements and related disclosures must be estimated by management, requiring certain assumptions to be made with respect to values or conditions that cannot be known with certainty at the time the consolidated financial statements are prepared. These estimates and assumptions affect the amounts the Company reports for assets and liabilities and the Company’s disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Actual results could differ from those estimates.

The Company evaluates these estimates on an ongoing basis, using historical experience, consultation with experts and other methods the Company considers reasonable in the particular circumstances. Nevertheless, actual results may differ significantly from the Company's estimates. Any effects on the Company's business, financial position or results of operations resulting from revisions to these estimates are recorded in the period in which the facts that give rise to the revision become known. Significant items subject to such estimates and assumptions include estimates of proved oil and natural gas reserves and related present value estimates of future net cash flows therefrom, the carrying value of oil and natural gas properties, asset retirement obligations, the fair value determination of acquired assets and liabilities, equity-based compensation, fair value estimates of commodity derivatives and estimates of income taxes.

Diamondback Energy, Inc. and Subsidiaries
Notes to Consolidated Financial Statements-(Continued)
(Unaudited)

New Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board issued Accounting Standards Update 2015-03, "Interest–Imputation of Interest". This update requires that debt issuance costs related to a recognized debt liability (except costs associated with revolving debt arrangements) be presented in the balance sheet as a direct deduction from that debt liability, consistent with the presentation of a debt discount, to simplify the presentation of debt issuance costs. This update is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early application was permitted for financial statements that have not previously been issued. The Company retrospectively adopted this new standard effective January 1, 2016. Adoption of this standard only affects the presentation of the Company's consolidated balance sheets and does not have a material impact on its consolidated financial statements.

In January 2016, the Financial Accounting Standards Board issued Accounting Standards Update 2016-01, "Financial Instruments–Overall". This update applies to any entity that hold financial assets or owe financial liabilities. This update requires equity investments (except for those accounted for under the equity method or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. This update will be effective for public entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, with early adoption permitted. Entities should apply the amendments by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. While this update will not have a direct impact on the Company, the Partnership will be required to mark its cost method investment to fair value with the adoption of this update.

In February 2016, the Financial Accounting Standards Board issued Accounting Standards Update 2016-02, "Leases". This update applies to any entity that enters into a lease, with some specified scope exemptions. Under this update, a lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. While there were no major changes to the lessor accounting, changes were made to align key aspects with the revenue recognition guidance. This update will be effective for public entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. Entities will be required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The Company is currently evaluating the impact that the adoption of this update will have on the Company's financial position, results of operations and liquidity.

In March 2016, the Financial Accounting Standards Board issued Accounting Standards Update 2016-08, "Revenue from Contracts with Customers - Principal versus Agent Considerations (Reporting Revenue Gross versus Net)". Under this update, an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This update will be effective for annual and interim reporting periods beginning after December 15, 2017, with early application not permitted. This update allows for either full retrospective adoption, meaning this update is applied to all periods presented in the financial statements, or modified retrospective adoption, meaning this update is applied only to the most current period presented. The Company is currently evaluating the impact, if any, that the adoption of this update will have on the Company's financial position, results of operations and liquidity.

In March 2016, the Financial Accounting Standards Board issued Accounting Standards Update 2016-09, "Compensation - Stock Compensation". This update applies to all entities that issue share-based payment awards to their employees. Under this update, there were several areas that were simplified including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This update will be effective for financial statements issued for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years with early adoption permitted. The Company is currently evaluating the impact that the adoption of this update will have on the Company's financial position, results of operations and liquidity.

3. VIPER ENERGY PARTNERS LP

The Partnership is a publicly traded Delaware limited partnership, the common units of which are listed on the NASDAQ Global Market under the symbol “VNOM”. The Partnership was formed by Diamondback on February 27, 2014, to, among other things, own, acquire and exploit oil and natural gas properties in North America. The Partnership is currently focused on oil and natural gas properties in the Permian Basin. Viper Energy Partners GP LLC,

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a fully-consolidated subsidiary of Diamondback, serves as the general partner of, and holds a non-economic general partner interest in, the Partnership. As of March 31, 2016, the Company owned approximately 88% of the common units of the Partnership.

Partnership Agreement

In connection with the closing of the Viper Offering, the General Partner and Diamondback entered into the first amended and restated agreement of limited partnership, dated June 23, 2014 (the “Partnership Agreement”). The Partnership Agreement requires the Partnership to reimburse the General Partner for all direct and indirect expenses incurred or paid on the Partnership’s behalf and all other expenses allocable to the Partnership or otherwise incurred by the General Partner in connection with operating the Partnership’s business. The Partnership Agreement does not set a limit on the amount of expenses for which the General Partner and its affiliates may be reimbursed. These expenses include salary, bonus, incentive compensation and other amounts paid to persons who perform services for the Partnership or on its behalf and expenses allocated to the General Partner by its affiliates. The General Partner is entitled to determine the expenses that are allocable to the Partnership.

Tax Sharing

In connection with the closing of the Viper Offering, the Partnership entered into a tax sharing agreement with Diamondback, dated June 23, 2014, pursuant to which the Partnership agreed to reimburse Diamondback for its share of state and local income and other taxes for which the Partnership’s results are included in a combined or consolidated tax return filed by Diamondback with respect to taxable periods including or beginning on June 23, 2014. The amount of any such reimbursement is limited to the tax the Partnership would have paid had it not been included in a combined group with Diamondback. Diamondback may use its tax attributes to cause its combined or consolidated group, of which the Partnership may be a member for this purpose, to owe less or no tax. In such a situation, the Partnership agreed to reimburse Diamondback for the tax the Partnership would have owed had the tax attributes not been available or used for the Partnership’s benefit, even though Diamondback had no cash tax expense for that period.

Other Agreements

See Note 10—Related Party Transactions for information regarding the advisory services agreement the Partnership and the General Partner entered into with Wexford Capital LP (“Wexford”).

The Partnership has entered into a secured revolving credit facility with Wells Fargo, as administrative agent sole book runner and lead arranger. See Note 7—Debt for a description of this credit facility.

Diamondback Energy, Inc. and Subsidiaries
Notes to Consolidated Financial Statements-(Continued)
(Unaudited)

4. PROPERTY AND EQUIPMENT

Property and equipment includes the following:

	March 31, 2016	December 31, 2015
	(in thousands)	
Oil and natural gas properties:		
Subject to depletion	$2,946,194	$2,848,557
Not subject to depletion-acquisition costs		
Incurred in 2016	16,377	—
Incurred in 2015	433,626	433,769
Incurred in 2014	511,279	543,399
Incurred in 2013	67,666	68,351
Incurred in 2012	61,298	61,297
Total not subject to depletion	1,090,246	1,106,816
Gross oil and natural gas properties	4,036,440	3,955,373
Accumulated depletion	(553,309)	(512,144)
Accumulated impairment	(928,778)	(897,962)
Oil and natural gas properties, net	2,554,353	2,545,267
Pipeline and gas gathering assets	7,174	7,174
Other property and equipment	49,763	48,621
Accumulated depreciation	(3,844)	(3,437)
Property and equipment, net of accumulated depreciation, depletion, amortization and impairment	$2,607,446	$2,597,625

The Company uses the full cost method of accounting for its oil and natural gas properties. Under this method, all acquisition, exploration and development costs, including certain internal costs, are capitalized and amortized on a composite unit of production method based on proved oil, natural gas liquids and natural gas reserves. Internal costs capitalized to the full cost pool represent management's estimate of costs incurred directly related to exploration and development activities such as geological and other administrative costs associated with overseeing the exploration and development activities. All internal costs not directly associated with exploration and development activities were charged to expense as they were incurred. Capitalized internal costs were approximately $5.0 million and $4.7 million for the three months ended March 31, 2016 and 2015, respectively. Costs associated with unevaluated properties are excluded from the full cost pool until the Company has made a determination as to the existence of proved reserves. The inclusion of the Company's unevaluated costs into the amortization base is expected to be completed within three to five years. Sales of oil and natural gas properties, whether or not being amortized currently, are accounted for as adjustments of capitalized costs, with no gain or loss recognized, unless such adjustments would significantly alter the relationship between capitalized costs and proved reserves of oil, natural gas liquids and natural gas.

Under this method of accounting, the Company is required to perform a ceiling test each quarter. The test determines a limit, or ceiling, on the book value of the proved oil and gas properties. Net capitalized costs are limited to the lower of unamortized cost net of deferred income taxes, or the cost center ceiling. The cost center ceiling is defined as the sum of (a) estimated future net revenues, discounted at 10% per annum, from proved reserves, based on the trailing

12-month unweighted average of the first-day-of-the-month price, adjusted for any contract provisions or financial derivatives, if any, that hedge the Company’s oil and natural gas revenue, and excluding the estimated abandonment costs for properties with asset retirement obligations recorded on the balance sheet, (b) the cost of properties not being amortized, if any, and (c) the lower of cost or market value of unproved properties included in the cost being amortized, including related deferred taxes for differences between the book and tax basis of the oil and natural gas properties. If the net book value, including related deferred taxes, exceeds the ceiling, an impairment or non-cash writedown is required.

As a result of the decline in prices during the three months ended March 31, 2016, the Company recorded non-cash ceiling test impairments for the three months ended March 31, 2016 of $30.8 million, which is included in

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accumulated depletion. The Company did not have any impairment of its proved oil and gas properties during the three months ended March 31, 2015. The impairment charge affected the Company's reported net income but did not reduce our cash flow. In addition to commodity prices, the Company's production rates, levels of proved reserves, future development costs, transfers of unevaluated properties and other factors will determine its actual ceiling test calculation and impairment analysis in future periods.

5. ASSET RETIREMENT OBLIGATIONS

The following table describes the changes to the Company's asset retirement obligation liability for the following periods:

	Three Months Ended March 31,	
	2016	2015
	(in thousands)	
Asset retirement obligation, beginning of period	$12,711	$8,486
Additional liability incurred	132	102
Liabilities acquired	796	47
Liabilities settled	(344)	—
Accretion expense	246	170
Revisions in estimated liabilities	88	78
Asset retirement obligation, end of period	13,629	8,883
Less current portion	67	39
Asset retirement obligations - long-term	$13,562	$8,844

The Company's asset retirement obligations primarily relate to the future plugging and abandonment of wells and related facilities. The Company estimates the future plugging and abandonment costs of wells, the ultimate productive life of the properties, a risk-adjusted discount rate and an inflation factor in order to determine the current present value of this obligation. To the extent future revisions to these assumptions impact the present value of the existing asset retirement obligation liability, a corresponding adjustment is made to the oil and natural gas property balance.

6. EQUITY METHOD INVESTMENTS

In October 2014, the Company paid $0.6 million for a 25% interest in HMW Fluid Management LLC, which was formed to develop, own and operate an integrated water management system to gather, store, process, treat, distribute and dispose of water to exploration and production companies operating in Midland, Martin and Andrews Counties, Texas. The board of this entity may also authorize the entity to offer these services to other counties in the Permian Basin and to pursue other business opportunities. The Company has committed to invest an aggregate amount of $5.0 million in this entity, and several other third parties have committed to invest an aggregate of $15.0 million. During the three months ended March 31, 2016, the Company invested an additional $0.8 million in this entity bringing its total investment to $4.1 million at March 31, 2016. The Company will retain a minority interest after all commitments are received. The entity was formed as a limited liability company and maintains a specific ownership account for each investor, similar to a partnership capital account structure. Therefore, the Company accounts for this investment under the equity method of accounting.

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7. DEBT

Long-term debt consisted of the following as of the dates indicated:

	March 31, 2016	December 31, 2015
	(in thousands)	
7.625 % Senior Notes due 2021	$450,000	$450,000
Unamortized debt issuance	(7,359)	(7,693)
Revolving credit facility	—	11,000
Partnership revolving credit facility	43,000	34,500
Total long-term debt	$485,641	$487,807

Senior Notes

On September 18, 2013, the Company completed an offering of $450.0 million in aggregate principal amount of 7.625% senior unsecured notes due 2021 (the “Senior Notes”). The Senior Notes bear interest at the rate of 7.625% per annum, payable semi-annually, in arrears on April 1 and October 1 of each year, commencing on April 1, 2014 and will mature on October 1, 2021. On June 23, 2014, in connection with the Viper Offering, the Company designated the Partnership, the General Partner and Viper Energy LLC as unrestricted subsidiaries and, upon such designation, Viper Energy LLC, which was a guarantor under the indenture governing of the Senior Notes, was released as a guarantor under the indenture. As of March 31, 2016, the Senior Notes are fully and unconditionally guaranteed by Diamondback O&G LLC, Diamondback E&P LLC and White Fang Energy LLC and will also be guaranteed by any future restricted subsidiaries of Diamondback. The net proceeds from the Senior Notes were used to fund the acquisition of mineral interests underlying approximately 14,804 gross (12,687 net) acres in Midland County, Texas in the Permian Basin.

The Senior Notes were issued under, and are governed by, an indenture among the Company, the subsidiary guarantors party thereto and Wells Fargo Bank, National Association (“Wells Fargo”), as the trustee, as supplemented (the “Indenture”). The Indenture contains certain covenants that, subject to certain exceptions and qualifications, among other things, limit the Company’s ability and the ability of the restricted subsidiaries to incur or guarantee additional indebtedness, make certain investments, declare or pay dividends or make other distributions on, or redeem or repurchase, capital stock, prepay subordinated indebtedness, sell assets including capital stock of subsidiaries, agree to payment restrictions affecting the Company’s restricted subsidiaries, consolidate, merge, sell or otherwise dispose of all or substantially all of its assets, enter into transactions with affiliates, incur liens, engage in business other than the oil and gas business and designate certain of the Company’s subsidiaries as unrestricted subsidiaries. If the Company experiences certain kinds of changes of control or if it sells certain of its assets, holders of the Senior Notes may have the right to require the Company to repurchase their Senior Notes.

The Company will have the option to redeem the Senior Notes, in whole or in part, at any time on or after October 1, 2016 at the redemption prices (expressed as percentages of principal amount) of 105.719% for the 12-month period beginning on October 1, 2016, 103.813% for the 12-month period beginning on October 1, 2017, 101.906% for the 12-month period beginning on October 1, 2018 and 100.000% beginning on October 1, 2019 and at any time thereafter with any accrued and unpaid interest to, but not including, the date of redemption. In addition, prior to

October 1, 2016, the Company may redeem all or a part of the Senior Notes at a price equal to 100% of the principal amount thereof, plus accrued and unpaid interest