

DIAMOND HILL

INVESTED IN THE LONG RUN

Small Company Monthly Musings

A Tale of Two Companies

Nov 2025

We all know how the famous opening line goes — “it was the best of times, it was the worst of times” — and in markets as well as business, the decisions you make at each of those ends of the spectrum have a critical impact on your long-term outcomes. This concept is of heightened importance for companies where the price of your primary asset — such as oil — is dictated to you. When the product you sell is priced daily by global forces far beyond your control, the decisions management makes in good times as well as bad are critical. Creating value comes less from predicting the cycle, and more from maintaining the discipline to steer through it.

One of the key tenets we continue to emphasize in our assessment of a business is using leverage wisely. Rarely does reality provide such a compelling illustration of the true “why” behind your philosophy; however, over the past several years, **Civitas Resources** and **Magnolia Oil & Gas** have offered a vivid contrast in this regard. Both operate in the same industry, facing the same volatility and the same investor scrutiny. Yet their choices have led them down very different paths and very different investor outcomes.

Civitas Resources began as a single-basin producer in Colorado’s DJ Basin — focused, disciplined and maintained a strong balance sheet, typically net cash. In its pursuit of growth in 2023, the company expanded into the Permian, becoming a dual-basin producer, taking on leverage and stepping a bit outside its traditional core competency. While we weren’t enthusiastic about the move, we remained patient to see how it would unfold: Debt definitively added fragility but did not appear egregious, cash flow remained strong, and management spoke of buybacks and balance sheet flexibility.

However, after a difficult first quarter earlier this year, the company’s posture reversed — a round of layoffs, halted buybacks and a redirected focus on debt reduction. The error in judgement became clear: What had once been presented as a position of strength now appeared as defensive retrenchment. In effect, Civitas found itself doing the opposite of what we look for in cyclical businesses. When times were good, it was buying back shares instead of paying down debt. When conditions turned, rather than investing counter-cyclically, the company hunkered down. In cyclical industries, we want our businesses to be deploying capital opportunistically — and we want confidence that we can also deploy capital into these businesses opportunistically. Our conviction in that ability has been eroded.

This is a reminder of how quickly a company can lose control when leverage and complexity enter the equation. A once straightforward, single-basin producer became a multi-basin operator whose destiny is now more path dependent on the next oil price move. We prefer businesses that define their own playbook, not those forced to respond to the market’s. The culmination of experience owning Civitas will be its merger with SM Energy. To highlight this numerically: from the end of 2020 to the company’s addition of debt to the balance sheet in the second quarter of 2023, Civitas compounded at nearly 80% annualized. That performance was largely offset by a return stream of more than -25% annualized from 30 June 2023 to the announcement of the merger with SM Energy on 3 November 2025.



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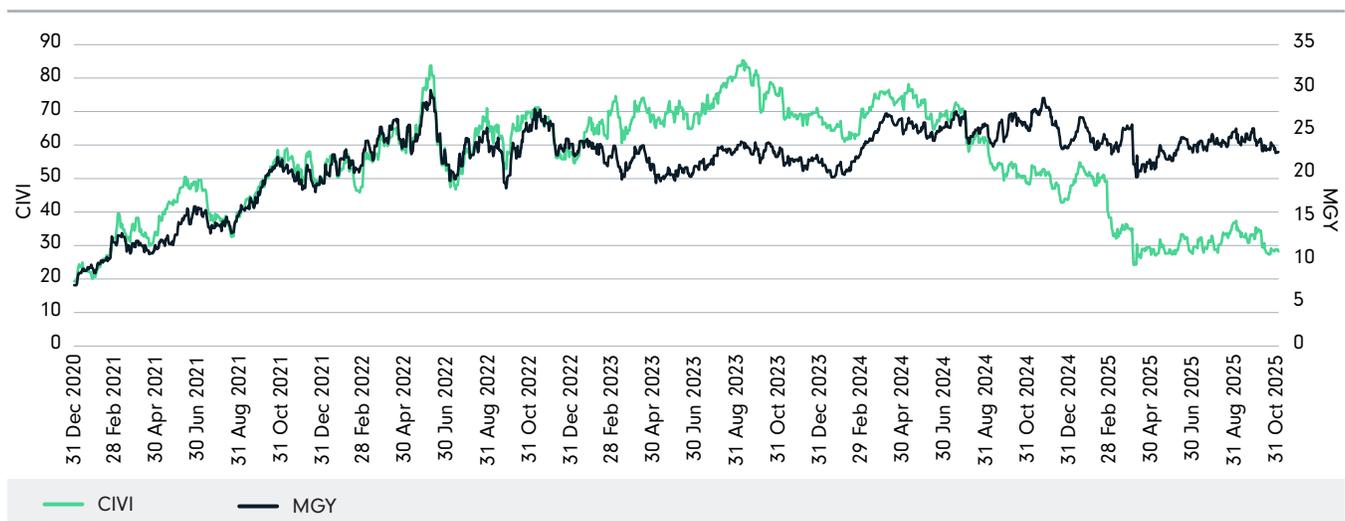
Magnolia Oil & Gas, by contrast, continues to exemplify the traits we value most in cyclical businesses. Magnolia is often misunderstood because it is based in a less favored basin – the Eagle Ford rather than the Permian. The company is also more conservative than peers on how it calculates PUD (proven undeveloped) reserves. We like that management runs the company with an ownership mindset – focused on returns, balance sheet strength and thoughtful capital allocation. The company doesn't rely on debt to drive growth or chase acquisitions for scale. It uses its own judgement, skills and capabilities to create long-term value.

By maintaining a rock-solid balance sheet, Magnolia preserves the ability to think and act counter-cyclically – to use the good times to strengthen the foundation rather than stretch it – which is what sets the company apart. Magnolia understands that in a business dictated by commodity prices, control must come from elsewhere. You can't set the price of oil, but you can decide how you allocate capital, when you take risk and how you prepare for the inevitable downturn. In contrast to the actions taken by Civitas these past few years, Magnolia has remained focused on blocking and tackling – pursuing small bolt-on acquisitions in areas adjacent to its existing acreage. It continues to deliver on the core attributes we value in the business: continued production outperformance, capital discipline and consistent cash return to shareholders.

This has delivered a more consistent return profile. Using the same time frames highlighted for Civitas, Magnolia Oil & Gas delivered mid-50% annualized returns from the end of 2020 to the end of Q2 2023, while preserving this appreciation in a more stagnant oil environment, compounding at 5.5% from 30 June 2023 to 3 November 2025.

Exhibit 1 illustrates the owner's experience. Fragility only shows up when the challenge has arrived. If you don't know beforehand, it is too late.

Exhibit 1 – Price History of Civitas (CIVI) and Magnolia Oil & Gas (MGY), 31 Dec 2020–3 Nov 2025



Source: FactSet.

Being a relatively concentrated manager, we do not have to own everything. We have chosen to shift our oil and gas exposure into Magnolia Oil & Gas – a business that operates in a fashion that exemplifies our key qualitative attributes. The company has a capacity to suffer and operates counter-cyclically, giving us confidence to deploy capital into its business during difficult times – and it does not take this capacity to suffer lightly. Magnolia uses leverage with the utmost prudence and seeks to preserve the gains earned when times were good. The best operators don't simply survive the cycle; they use it to their advantage.

As of 31 October 2025, Diamond Hill owned shares of Civitas Resources Inc and Magnolia Oil & Gas Corp.

Performance for the strategy is available here: [Small Cap](#). Securities referenced may not be representative of all portfolio holdings. The reader should not assume that an investment in the securities was or will be profitable.

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