Strategic Consulting Group

Success Story - Capital Allocation & Uncertainty

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THE CHALLENGE

Our client was a venture-backed, exploration-focused energy company with a limited capital budget to invest between prospects in two distinct exploration plays. The CEO approached us for help defining their strategic goals and assessing what percentage of money should be allocated to each type of exploration play.

The company was staffed by experienced explorationists and was led by a savvy management team with a great deal of industry experience. Management knew that investors had to see demonstrable results before they could secure any additional funding. The explorationists knew the potential of the subsurface they were in, but the company struggled to develop a plan that successfully married operational upside with financial realities to the satisfaction of their investors.

THE SOLUTION

We began by working with each group of stakeholders – management and investors – to better understand what defined success for them. In particular, we focused on the time frame for material results to be achieved and the confidence levels that both groups wanted to have in their key strategic goals.

Working with company staff, we built a model of surrogate projects that represented the full spectrum of investment opportunities available in each of these two regions. Each project was further refined to include the appropriate amount of uncertainty for a prospect with its characteristics. When selected into portfolios, projects would reflect both operational and financial results, and using built-in Monte Carlo simulation, could show a range of results for each portfolio.

Working with the company management and their investors, we developed a series of alternate investment scenarios illustrating the performance trade offs they could expect, depending upon the strategic goals they defined. We then refined their goals into a success threshold that would have to be met to secure additional funding – 70% confidence of a particular production stream in five years' time.

THE RESULT

The vast majority of the acceptable scenarios invested in only one of the two plays. The management team was surprised to see that whenever they invested in the second play area, the probability of meeting goals decreased by more than 35%. Investors and management alike agreed that the only viable path forward was full investment in one of the regions. Investment in the other region was delayed until the preliminary set of projects had been sufficiently de-risked so they could be sold and used to finance the other set of projects.

The client used this information to develop their strategy over the ensuing years, securing additional funding before ultimately issuing an IPO.

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