

## Understanding the Intrinsic Value of an Exploration and Production Company

### *Industry & Client Situation*

After years of rapid production growth, high natural gas and oil prices, and plentiful reserves made them a darling on Wall Street, the economic downturn and commodity price volatility of 2008 caused a worse-than-market drop in a small-cap exploration and production company's stock price. With credit markets tight and significant capital expenditure requirements in order to maintain production levels, executives and the Board of Directors wondered whether to "stay the course" or if something more radical was necessary.

A robust valuation model was needed to understand not only "as-is" enterprise value, but what would happen if operational improvements were made, assets were reconfigured, and/or the company was financially restructured. Understanding maximized intrinsic value and comparing it with market value was a critical input to any strategic decision company leadership would evaluate.

### *Approach*

We proposed creating a flexible model that would separately value every segment of the company. Inputs to value included:

- Present value of cash flows from existing production and planned capex in each basin
- Present value of reserves at end of production cycle
- Present value of other revenue sources (natural gas marketing, well operations and pipeline income, risk management)
- Undeveloped acreage positions
- Cash on hand

We collaborated with nearly every function of the organization to obtain necessary data inputs and verify assumptions. Every input created could be modified, allowing for planning scenarios and sensitivities to be tested with ease.

### *Results*

The proposed solution, centered on understanding sources and drivers of intrinsic value, was received positively at all levels of the client. The model is currently being utilized as an input into their strategic planning process and has been used to evaluate potential mergers and acquisitions.

More importantly, the process altered the client's understanding of value and provided them with invaluable information. The valuation gave them visibility into what basins created the most value on an aggregate basis and on a per CAPEX dollar invested basis (e.g. "bang per buck"). Needless to say the results were surprising!