# Range Resources and the Pennsylvania Superior Court

Yesterday a court ruling in Pennsylvania cast doubt on the title of thousands of shale gas leases, as reported in Bloomberg . Range Resources (RRC) is as heavily invested in the Marcellus shale area, which includes Pennsylvania, as any other company out there. The company is well run and we like the management. The stock has also been exceptionally buoyant recently on takeover rumors. However, this news will likely put any potential acquisition on hold until the title issues are resolved, either by the Pennsylvania State Supreme Court or through state legislation. We are not currently invested in RRC although had been invested until recently when the U.S. Geologic Survey revised down their forecast of total reserves available in the Marcellus (which runs from NY State to Tennessee). This may create an opportunity to invest at lower prices once the story has had some time to play out.

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# Natural Gas and the Marcellus Shale

There always seems to be something to say on this topic. Although natural gas E&P companies typically represent 15-20% of our Deep Value Equity strategy, they provide disproportionate volatility but have also provided very good returns. The U.S. Geological Survey (USGS) is a Federal agency that gathers information and publishes research on the environment and natural resources A week ago they published a report on the amount of natural gas in the Marcellus Shale, an enormous area which runs from New York State to Alabama. They estimated that the “mean undiscovered natural gas resource” in this region is 84 TCFE (trillion cubic feet equivalent). They use the mean because the science isn’t certain and they have various forecasts with different levels of certainty. 84 TCFE is a lot of gas, roughly four times annual U.S. consumption. But this estimate is sharply lower than previous ones, and as a result the Energy Information Agency (EIA) whose job it is to forecast available energy resources, said it would slash its previous forecast of Marcellus availability by 80%. The EIA is deferring to the scientists at the USGS.

Range Resources (RRC) has long been a core holding of ours. The company is largely focused on extracting natural gas from the Marcellus Shale where it was one of the early movers. We like the company very much. It’s run by smart people who understand their business and is focused on increasing shareholder value. RRC has among the most efficient operating structures of any of its peers, and perhaps the cheapest F&D (Finding and Development) costs in the Marcellus. Current President and COO Jeff Ventura will be taking over from John Pinkerton as CEO in January in what will probably be a seamless transition. Jeff has an engineering background and has led their successful activities in the Marcellus to this point.

RRC reports total resource potential of 40-56 TCFE, of which 22-32 TCFE is in the Marcellus (and mostly in Pennsylvania). When the EIA was forecasting around 400 TCFE in the entire Marcellus area, this seemed fine. However, the revised 84 TCFE figure probably can’t be reconciled with RRC’s forecast (which is an estimate of resource potential, not proved reserves). We wouldn’t bet against RRC. They’ve been extracting increasing volumes of natural gas from this area for a long time and know the geology well. But Chesapeake Energy (CHK) estimates they have 93 TCFE of potential (“unrisked, unproved” is their definition). Something’s going to have to give. An intriguing possibility is that if the Marcellus ultimately delivers less than expected, other shale plays could be substantially more valuable given the resultant drop in long term natural gas supply. For our part, while we continue to like RRC we recently shifted into Devon Energy (DVN), which provides more diversified natural gas exposure and is also a very well run company. DVN’s market cap is approximately equal to its proved reserves (i.e. potential reserves are not reflected in the price). They have very little debt, are buying back stock and should earn $6-7 per share next year which makes an attractive multiple given their $67 price. DVN is in many different unconventional natural gas areas, but not in the Marcellus. The Marcellus Shale story no doubt has more chapters to come.