

Chesapeake



Letter to Shareholders - First Quarter 2004

Dear Fellow Shareholders:

We are pleased to again share with you another quarter of exceptional results from Chesapeake. In fact, the 2004 first quarter marks the eleventh consecutive quarter of record production and proved reserve increases at our company. In addition, our financial performance set all-time records for the company. We believe the consistency of our operating and financial performance remains one of the most important distinguishing characteristics of Chesapeake.

Furthermore, we continued to invest significant capital in helping ensure Chesapeake's future success. During the quarter, we announced or completed acquisitions of almost \$600 million in proved oil and gas reserves and financed the acquisitions with new issues of common and preferred stock, thereby significantly improving our balance sheet. In addition, we invested \$176 million in drilling new wells and invested an additional \$49 million in leasehold and 3-D seismic information. Through these aggressive investments in the building blocks for future success, Chesapeake continues to execute on the successful and distinctive business strategy that has made our company one of the very best explorers, acquirers and producers of onshore natural gas in the U.S.

Operating and Financial Highlights

The following information highlights the strength of Chesapeake's operational and financial performance during the 2004 first quarter as compared to the 2003 first quarter:

- * Oil and gas production reached a record level of 78.9 billion cubic feet of natural gas equivalent (bcfe), up 39%;
- * Oil and gas proved reserves increased to a record level of 3.5 trillion cubic feet equivalent (tcf), up 25%;
- * Total revenue climbed to a record level of \$563 million, up 50%;
- * Operating cash flow*** reached a record level of \$334 million, up 99%, and most importantly;
- * Net income available to common shareholders increased to a record \$104 million, up 49%.

Record Production Generated by Drilling Success and Acquisitions

Oil and natural gas production for the 2004 first quarter was the company's best ever and marked the eleventh consecutive quarter of production growth. During these 11 quarters, Chesapeake's production has increased 102%, for an average sequential quarterly growth rate of 6.6% and an average annualized growth rate of 29%. We believe this is the best track record of growth among mid- and large-cap independent producers in the U.S. during this period and helps explain why Chesapeake's stock price

performance has been the best among our mid- and large-cap peers during these 11 quarters.

During the 2004 first quarter, Chesapeake's natural gas equivalent production rose to 78.9 bcfe, an increase of 22.1 bcfe, or 39%, over the 56.8 bcfe produced in the 2003 first quarter. This 22.1 bcfe increase over the year-ago quarter also highlights the company's balanced growth profile, with 11.1 bcfe of production growth generated from successful drilling and 11.0 bcfe delivered from producing property acquisitions.

We believe the company's year-over-year organic growth rate of 20% was among the very best performances reported by public mid- and large-cap U.S. independent producers during the past 12 months. Chesapeake's 20% organic growth rate is especially noteworthy when contrasted against the overall U.S. natural gas production decline rate of 2-3% per year. Chesapeake's ability to grow its production organically while the industry's production is declining is another distinctive characteristic of our company. This production growth reflects the success of Chesapeake's deep natural gas drilling programs, its lower-risk developmental gas drilling programs and the company's strong commitment to investing in the human capital, new leasehold and 3-D seismic information that form the foundation for future success.

These investments in the future success of our company have enabled Chesapeake to build an inventory of over three million acres of leasehold and over 800,000 acres of 3-D seismic coverage. On that vast prospect inventory, the company drilled 118 gross (88 net) operated wells and participated in another 137 gross wells (21 net) operated by other companies during the 2004 first quarter, at a drilling success rate of 96%. Chesapeake plans to maintain an active drilling campaign during the remainder of the year, using an average of 50 operated drilling rigs and 50 non-operated rigs.

Proved Oil and Natural Gas Reserves Set Records

During the first quarter, Chesapeake replaced its 78.9 bcfe of production by 473%, discovering or acquiring 373 bcfe at a drilling and acquisition cost of \$1.66 per mcfe (excluding investments in unevaluated leasehold and in seismic information). Reserve replacement through the drillbit was 146% and through acquisitions was 327%. At the end of the 2004 first quarter, Chesapeake's estimated proved reserves were 3.5 tcf, an increase of 25% over the 2.8 tcf estimated by the company at the end of the 2003 first quarter.

First Quarter Acquisitions Strengthen Secondary Operating Areas

Chesapeake continued to actively invest on the acquisitions front during the quarter, investing \$585 million in six announced or completed transactions, most notably the \$420 million acquisition of privately-held Concho Resources Inc. Through these accretive transactions, the company acquired 366 bcfe of proved reserves, 251 bcfe of probable or possible reserves*, 92,000 gross acres of leasehold and 82 million cubic feet of gas equivalent (mmcfe) daily production. These acquisitions were focused in the Permian Basin of west Texas and eastern New Mexico, but also included assets in South Texas, along the Texas Gulf Coast and in the Mid-Continent. All of these acquisitions have now been closed and have been integrated into our existing operations.

Profit Margins Expand Through Higher Prices, Successful Hedging and Strong Cost Controls

Chesapeake's revenue realizations and operating margins continued to expand during the quarter as the supply and demand issues surrounding oil and natural gas that we have consistently discussed during the past six years continued to play out as we have been anticipating. However, in addition to riding the wave of higher oil and natural gas prices, the company has continued to be an industry leader in

maintaining a low operating cost structure and enhancing its revenues through successful commodity price hedging practices.

On top of the already high oil and gas prices received by the company at the wellhead during the quarter that averaged \$5.17 per mcfe, Chesapeake increased its revenues by nearly \$26 million, or \$0.33 per mcfe through its realized gains from oil and natural gas price hedging. In addition, the company's total operating costs during the 2004 first quarter decreased by 16% due to reductions in per unit production tax and interest expense. As a result, Chesapeake's profit margin during the 2004 first quarter increased by 71% over that of the 2003 first quarter.

Management's Outlook

The 2004 first quarter was another in a three-year succession of record quarterly results for Chesapeake and follows an exceptionally strong 2003 annual performance. With the filing of our peer companies' Form 10-K reports for 2003, we thought you would find it interesting, as we did, to compare our company's 2003 performance with that of our peer group's 2003 performance. We hope you will share our pride in Chesapeake's 2003 industry-leading results:

- * #1 in stock price appreciation, up 75%;
- * #1 in proved reserves growth, up 44%;
- * #1 in production growth, up 48%;
- * #1 in % of gas production, 90%;
- * #1 in shareholders' equity % increase, up 91%;
- * #1 in oil and natural gas revenue per mcfe, \$4.79;
- * #1 in lowest G&A per mcfe, \$0.09;
- * #1 in ebitda** per mcfe, \$3.88;
- * #2 (tied) for lowest LOE per mcfe, \$0.51;
- * #4 in cash flow*** per mcfe, \$3.37.

CHK's peer companies are: APA, APC, BR, COG, DVN, ECA, EOG, FST, KMG, NBL, NFX, PPP, PXD, VPI, and XTO.

Although we cannot guarantee a repeat of these rankings in 2004 or in future years, continuing the company's track record of delivering exceptional operating and financial performance will remain our #1 objective. Furthermore, we believe the combination of Chesapeake's focused product and geographic strategies, our value-added risk management strategy, our balanced acquisition and drilling programs, our high quality assets and our low operating costs will enable Chesapeake to consistently deliver one of the industry's best track records of value creation, year after year.

We appreciate the confidence you have demonstrated in us through your investment in our company and we look forward to continuing to deliver on our goal of generating industry-leading shareholder value to you in the years ahead.

Best regards,

Aubrey K. McClendon
Chairman and Chief Executive Officer

Tom L. Ward
President and Chief Operating Officer

April 30, 2004

*The SEC has generally permitted oil and gas companies, in filings made with the SEC, to disclose only proved reserves that a company has demonstrated by actual production or conclusive formation tests to be economically and legally producible under existing economic and operating conditions. We use the terms “probable” and “possible” reserves or other descriptions of volumes of reserves potentially recoverable through additional drilling or recovery techniques that the SEC’s guidelines may prohibit us from including in filings with the SEC. These estimates are by their nature more speculative than estimates of proved reserves and accordingly are subject to substantially greater risk of being actually realized by the company. We cannot assure you that we can recover our estimated volumes of oil and natural gas reserves.

** Ebitda is a non-GAAP measure that represents net income before the cumulative effect of accounting change, income tax expense, interest expense and depreciation, depletion and amortization expense.

*** Operating cash flow is a non-GAAP measure that represents net cash provided by operating activities before changes in assets and liabilities.

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