

# Chesapeake



## Letter to Shareholders - Third Quarter 2005

### Dear Fellow Investors:

We are pleased to deliver another quarter of record performance from your company. In the 2005 third quarter, Chesapeake recorded its 17th consecutive quarter of sequential production growth and yet another strong quarter of operational and financial performance. As we move through the 2005 fourth quarter and prepare for 2006, we will continue building a strong foundation for favorable long-term stock price performance.

### Record Production Reported

Chesapeake's production for the 2005 third quarter was 120.4 billion cubic feet of natural gas equivalent (bcfe), resulting in average daily production of 1.308 bcfe, an increase of 28% over the 1.024 bcfe produced per day in the 2004 third quarter and an increase of 5% over the 1.244 bcfe produced per day in the 2005 second quarter.

Of the 5% increase in sequential quarterly production, 53% came from organic growth and 47% from acquisition growth, making the company's quarterly organic growth rate 3%, its year-to-date organic growth rate 8% and its annualized 2005 organic growth rate 11%. During the past 17 quarters, Chesapeake's U.S. production has increased 234%, for an average compound annual growth rate of 33% and an average compound quarterly growth rate of 7%. We are extremely proud of this singular achievement in our industry.

### Operational Results Remain Strong

Chesapeake's organic growth continues to exceed the company's forecasts and distinguishes the company among its peers. During the 2005 third quarter, Chesapeake drilled 241 gross (186 net) operated wells and participated in another 278 gross (32 net) wells operated by other companies. The company's drilling success rate was 97% for both company operated wells and non-operated wells. During the quarter, Chesapeake invested \$390 million in operated wells (using an average of 72 operated rigs), \$75 million in non-operated wells (using an average of 65 non-operated rigs) and \$91 million in acquiring new 3-D seismic data and new leasehold (excluding leasehold acquired through acquisitions).

### Upside Inventory Continues to Grow

During the past seven years, Chesapeake has built the largest inventories of onshore leasehold (8.0 million net acres) and 3-D seismic (11.0 million acres) in the U.S. On this leasehold, we have identified

a 10-year backlog of over 25,000 drillsites on which we believe the company can develop approximately 2.6 trillion cubic feet of natural gas equivalent (tcfe) of proved undeveloped reserves and 7.0 tcfe of unproved reserves.

Chesapeake characterizes its drilling activity by one of four play types: conventional gas resource, unconventional gas resource, emerging gas resource and Appalachian Basin gas resource. The company's leasehold and proved undeveloped and unproved reserve totals are set forth below:

\* 2.6 million net acres in our traditional conventional gas resource areas (i.e., much of the Mid-Continent, Permian, Gulf Coast, South Texas and other areas) on which we have identified approximately 2,300 drillsites, 1.0 tcfe of proved undeveloped reserves and 1.0 tcfe of unproved reserves;

\* 1.0 million net acres in our unconventional gas resource areas (i.e., Sahara, Granite/Cherokee/Atoka Washes, Hartshorne CBM, Barnett Shale and Ark-La-Tex tight sands) on which we have identified approximately 12,000 drillsites, 1.2 tcfe of proved undeveloped reserves and 3.4 tcfe of unproved reserves;

\* 0.9 million net acres in our emerging gas resource areas (i.e., Fayetteville Shale, Caney/Woodford Shales, Haley Deep and others) on which we have identified approximately 1,200 drillsites, 0.1 tcfe of proved undeveloped reserves and 1.2 tcfe of unproved reserves; and

\* 3.5 million net acres in the Appalachian Basin, where play types range from conventional to unconventional to emerging gas resource. On the significant acreage base acquired from Columbia Natural Resources (CNR), we have identified approximately 9,400 drillsites, 0.3 tcfe of proved undeveloped reserves and 1.4 tcfe of unproved reserves.

Chesapeake continues to actively acquire more acreage throughout its operating areas with almost 500,000 acres acquired in the 2005 third quarter through an aggressive land acquisition program that is utilizing more than 600 landmen in the field. During the quarter, the company's most significant land acquisition activities took place in the Fayetteville Shale play in Arkansas, where the company increased its holdings to more than 600,000 net acres. Chesapeake's initial seven well drilling program in the Fayetteville Shale is now underway.

### *CNR Transaction*

At the end of the third quarter, we announced the acquisition of CNR, the largest transaction in the company's history. Through this transaction, Chesapeake acquired daily net production of 125 million cubic feet of natural gas equivalent (mmcfe) and an internally estimated 2.5 tcfe of proved, probable and possible (3P) reserves, comprised of 1.1 tcfe of proved reserves and 1.4 tcfe of probable and possible reserves. The purchase price was approximately \$2.95 billion, which consisted of \$2.2 billion in cash and \$0.75 billion in liabilities assumed at closing.

Chesapeake now owns an internally estimated 14.3 tcfe of proved and unproved oil and natural gas reserves, comprised of 7.3 tcfe of proved reserves (which are 92% natural gas and 100% onshore) and 7.0 tcfe of unproved reserves.

After allocating \$175 million of the purchase price to the extensive mid-stream natural gas assets acquired and \$500 million to the unevaluated portion of the 4.1 million net leasehold acres acquired, Chesapeake's acquisition cost for the 1.1 tcfe of internally estimated proved reserves was \$2.275 billion,

or \$2.20 per thousand cubic feet of natural gas equivalent (mcf). In conjunction with the CNR acquisition, Chesapeake hedged 100 billion cubic feet (bcf) at an average price of \$10.76 per mmbtu, which is approximately two years of anticipated production from the CNR properties. This hedged price significantly exceeds the pricing assumptions we used to value CNR.

### Management's CNR Summary

The CNR transaction fits well with our distinctive onshore U.S. natural gas focused strategy. First, we are enthusiastic about moving into a large and prolific natural gas basin. The Appalachian Basin covers over 185,000 square miles (almost three times the size of Oklahoma) across seven states and has produced more than 46 tcf of gas from over 400,000 wells.

Second, much of the basin remains underexplored. Less than 1% of the 400,000 wells drilled to date have penetrated below 7,500 feet, leaving substantial deeper exploration opportunities available for Chesapeake to pursue. In addition, very few horizontal wells have been drilled and very few wells have been cored, leaving a great opportunity for Chesapeake to apply new scientific approaches to gas development in the region.

Third, we are also attracted to the value proposition of producing natural gas at a premium price to NYMEX, rather than for the steep discount to NYMEX that most other U.S. natural gas sells for today. Including an approximate 14% value upgrade for the rich BTU content of the gas, we believe prices realized on Chesapeake's Appalachian gas production today are up to \$4.00 per mcf higher than prices received in most southwestern and western U.S. gas basins.

In addition, we are eager to begin working in a large U.S. natural gas basin that shares many similarities to our stronghold in the Mid-Continent. As in the Mid-Continent area seven years ago, Appalachian Basin asset ownership today is very fragmented and ripe for consolidation. We further believe that Chesapeake's significant presence in the Barnett, Woodford, Caney and Fayetteville shale plays, our expertise in tight sand and horizontal drilling and our commitment to deep natural gas exploration will enable us to achieve success in developing our Appalachian properties.

Finally, it has become abundantly clear in recent months that the U.S. needs significant additional supplies of clean-burning, domestically-produced onshore natural gas. During the past five years, Chesapeake has stood out among its peers as the most active driller in the U.S. and has discovered and developed major new supplies of natural gas that U.S. consumers increasingly need. In 2006, the company plans to respond once again to the market's need for more natural gas by expanding our drilling activity level to an average of at least 85-90 drilling rigs. While others in the industry are increasingly focused on international projects, Chesapeake remains committed to supplying consumers with as much natural gas as we can find onshore in the U.S.

### Management's Outlook

Chesapeake's very strong operational and financial results during the 2005 third quarter provide ongoing confirmation that Chesapeake's business strategy continues to create significant value for investors. This strategy has generated more than an 80% increase in our common stock price during the past year and more than a 20-fold increase since our IPO in February 1993 through:

- \* delivering consistent and value-added growth through a balance of acquisitions and exploratory and developmental drilling;

- \* focusing on natural gas to take advantage of strong long-term natural gas supply/demand fundamentals; and

\* building dominant regional scale to achieve low operating costs and high returns.

Just at the time when our country needs significant new supplies of onshore natural gas, Chesapeake has become the nation's second largest independent producer of U.S. natural gas and the fifth largest overall. Our timing, preparation and execution have been excellent and we believe Chesapeake's management team can continue to successfully execute the company's distinctive business strategy and deliver significant shareholder value in the years to come.

Best regards,

Aubrey K. McClendon  
Chairman and Chief Executive Officer

Tom L. Ward  
President and Chief Operating Officer  
November 15, 2005

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