

Chesapeake



Letter to Shareholders - Second Quarter 2007

Dear Fellow Investors

Without a doubt, the second quarter of 2007 will go down in Chesapeake's history as our best operational quarter yet. We overtook two large independents and one major to become the largest independent and third-largest overall producer of natural gas in the U.S. Today, only two companies produce more domestic natural gas than Chesapeake. Given our production growth rate, it seems inevitable that Chesapeake will become the largest producer of U.S. natural gas sometime during 2008.

Strong Financial Performance

For the 2007 second quarter, Chesapeake generated net income available to common shareholders of \$492 million (\$1.01 per fully diluted common share), operating cash flow ⁽¹⁾ of \$1.076 billion and ebitda ⁽²⁾ of \$1.401 billion on revenue of \$2.105 billion and production of 170 billion cubic feet of natural gas equivalent (bcfe). The company's net income available to common shareholders and ebitda for the quarter include an unrealized after-tax mark-to-market gain of \$99 million resulting from the company's oil and natural gas and interest rate hedging programs and an after-tax gain of \$51 million from the sale of an investment. These types of items are typically not included in published estimates of the company's financial results by certain securities analysts. Excluding these items, Chesapeake generated adjusted net income to common shareholders ⁽³⁾ in the 2007 second quarter of \$342 million (\$0.71 per fully diluted common share) and adjusted ebitda ⁽⁴⁾ of \$1.167 billion.

Production Sets New Quarterly Record

The 2007 second quarter marked Chesapeake's 24th consecutive quarter of sequential production growth. Over these 24 quarters, Chesapeake's production has increased 372%, for an average compound quarterly growth rate of 7% and an average compound annual growth rate of 30%. Chesapeake's daily production during the 2007 second quarter averaged 1.868 bcfe, an increase of 300 million cubic feet of natural gas equivalent (mmcfe), or 19%, over the 1.568 bcfe of daily production in the 2006 second quarter and an increase of 161 mmcfe, or 9%, over the 1.707 bcfe produced per day in the 2007 first quarter. Chesapeake's rate of production recently exceeded 1.975 bcfe per day and, based on projected drilling levels and anticipated results, we are now forecasting total production growth of 18-22% for 2007 and 14-18% for 2008, both of which are increases of 400 basis points from our projections of just three months ago.

Proved Reserves Also Set New Record

In addition to generating strong production growth, the company increased its proved reserves to a record level. Chesapeake began 2007 with estimated proved reserves of 8.956 trillion cubic feet of natural gas equivalent (tcf) and ended the second quarter with 9.979 tcf, an increase of 1.023 tcf, or 11%. During the 2007 first half, Chesapeake replaced its 324 bcfe of production with an estimated 1.347 tcf of new proved reserves for a reserve replacement rate of 416%. Reserve replacement through the drillbit was 1.145 tcf, or 354% of production (including 510 bcfe of positive performance revisions and 95 bcfe of positive revisions resulting from oil and natural gas price increases between December 31, 2006, and June 30, 2007) and 85% of the total increase. Reserve replacement through the acquisition of proved reserves completed during the 2007 first half was 202 bcfe, or 62% of production and 15% of the total increase.

Drilling Program Continues at Industry-Leading Pace

Chesapeake continued the industry's most active drilling program during the 2007 first half, drilling 977 gross (835 net) operated wells and participating in another 826 gross (115 net) wells operated by other companies. The company's drilling success rate was 99% for company-operated wells and 97% for non-operated wells. Also during the 2007 first half, Chesapeake invested \$1.932 billion in operated wells (using an average of 131 operated rigs), \$314 million in non-operated wells (using an average of 102 non-operated rigs), \$410 million to acquire new leasehold (exclusive of \$665 million in unproved leasehold obtained through corporate and asset acquisitions, as well as other leasehold fees and related capitalized interest) and \$134 million to acquire seismic data.

Hedging Activities Continue to Create Value and Mitigate Risk

During the 2007 second quarter, Chesapeake generated a realized hedging gain of \$198 million, or \$1.16 per thousand cubic feet of natural gas equivalent (mcf). Realized gains from oil and natural gas hedging activities during the quarter generated a \$5.27 gain per barrel (bbl) and a \$1.19 gain per thousand cubic feet (mcf). For the 2007 first half, our realized gains from oil and natural gas hedging activities generated a \$6.74 gain per bbl and a \$2.02 gain per mcf for a total realized hedging gain of \$631 million, or \$1.95 per mcf. We believe that oil and natural gas prices will remain volatile as increasing worldwide demand for energy, changing weather patterns and challenging geopolitical issues continue to heavily influence energy markets. In the years ahead, we will continue our efforts to realize value for Chesapeake's investors by taking advantage of this volatility.

Drilling Inventory Further Expands

Since 2000, Chesapeake has invested \$7.8 billion in new leasehold and 3-D seismic acquisitions and now owns the largest combined inventories of onshore leasehold (12.2 million net acres) and 3-D seismic (17.7 million acres) in the U.S. On this leasehold, the company has approximately 28,500 net drilling locations, representing an approximate 10-year inventory of drilling projects, on which it believes it can develop an estimated 3.8 tcf of proved undeveloped reserves and approximately 20.8 tcf of risked unproved reserves (82 tcf of unrisked unproved reserves).

To aggressively develop these assets, Chesapeake has continued to significantly strengthen its technical capabilities by increasing its land, geoscience and engineering staff to over 1,200 employees. Today, the company has approximately 5,800 employees, of whom approximately 60% work in the company's E&P operations and approximately 40% work in the company's oilfield service operations.

Barnett Shale Remains Biggest Driver of Production Growth

The Fort Worth Barnett Shale is the largest and most prolific unconventional gas resource play in the U.S. In this play, Chesapeake is the third-largest producer of natural gas, the most active driller and the largest leasehold owner in the Core and Tier 1 sweet spot of Tarrant, Johnson and western Dallas counties. Chesapeake's current production of approximately 230 mmcf net per day from the Fort Worth Barnett Shale is double the level of a year ago and is expected to exceed 300 mmcf net per day by year-end 2007. The company is currently using 35 operated rigs to further develop its 230,000 net acres of leasehold, of which 180,000 net acres are located in the Core and Tier 1 area. In the 2007 second half, Chesapeake expects to use 35-38 operated rigs in the play and to be completing, on average, one new Barnett Shale well every 16 hours.

The purpose of our large-scale Barnett drilling ramp-up is to make the enormous upside embedded in our acreage position more visible and tangible by turning our non-producing leases into producing assets. We expect to see further impressive increases in Chesapeake's Barnett production throughout 2008. In fact, we can see Chesapeake's Barnett production increasing through at least 2010 as we remain on track to complete approximately 2,200 new wells in that timeframe. The future impact of those wells should be substantial, especially considering that we have drilled fewer than 500 wells in the play to date.

I would also like to highlight our Dallas/Fort Worth International Airport drilling activity. We are currently utilizing five rigs to drill on this 18,000-acre lease, the largest contiguous lease in the play. We have reached total depth on 12 wells to date, and are reaching total depth on a new well approximately every four to five days. The Barnett Shale underneath the airport looks excellent and is the thickest we have seen in the entire play. We will begin completing our first wells at the end of August and we are hopeful that these wells will be among the best drilled to date in the entire play.

Management Outlook

Our operational and financial results for the 2007 second quarter clearly demonstrate the benefits of Chesapeake's strategic shift from resource capture to resource conversion. During the quarter, we exceeded our midyear production and reserve growth expectations and became the nation's largest independent and third-largest overall producer of U.S. natural gas. Our sequential quarter and year-over-year production growth levels of 161 mmcf and 300 mmcf per day are at the top of the U.S. exploration and production industry.

Through the industry's most active drilling program, we plan to increase our average daily production rate by 18-22% in 2007 and 14-18% in 2008. We also expect to exceed 10.5 tcf of proved reserves by year-end 2007 and approach 12 tcf by year-end 2008. Further, the company continues to deliver attractive profit margins that are enhanced by our well-executed hedging strategy. Our focused business strategy, value-added growth platform, tremendous inventory of undrilled locations and valuable hedge positions continue to clearly differentiate Chesapeake as one of the very best value creators in the industry.

Finally, natural gas is emerging as the most practical solution to the challenge of how to become more energy independent in America in an increasingly dangerous world while reducing greenhouse gas emissions in a growing economy. The vast majority of greenhouse gas emissions are caused by transportation vehicles burning gasoline or diesel and by power plants burning coal. However, burning natural gas instead of gasoline, diesel or coal reduces greenhouse gas emissions by more than 50%. We believe the evidence clearly demonstrates that natural gas is by far the most practical solution to the challenge – it is abundant, affordable, reliable, clean burning and domestically produced.

For many years, natural gas has been valued at a BTU discount to oil. We believe the intensifying clean air and climate change debates present an opportunity for increased appreciation of natural gas and a higher valuation for the superior fuel we produce. We intend to do well for our shareholders by doing good for our country and our world by producing greater amounts of natural gas. I look forward to reporting continued success to you as the year progresses.

Best regards,
Aubrey K. McClendon
Chairman and Chief Executive Officer
August 3, 2007

(1) *Operating cash flow is net cash provided by operating activities before changes in assets and liabilities.*

(2) *Ebitda is net income before income tax expense, interest expense, and depreciation, depletion and amortization expense.*

(3) *Adjusted earnings is net income available to common shareholders excluding, on an after-tax basis, unrealized (gains) losses on derivatives and gain on sale of investments.*

(4) *Adjusted ebitda is net income before income tax expense, interest expense, and depreciation, depletion and amortization expense, adjusted to exclude unrealized (gains) losses on oil and natural gas derivatives and gain on sale of investments.*

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