

FINAL TRANSCRIPT

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CHK - Chesapeake Energy Corporation Announces 2007 Fourth Quarter and Full-Year Production and Proved Reserves Call

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Feb. 15. 2008 / 9:00AM, CHK - Chesapeake Energy Corporation Announces 2007 Fourth Quarter and Full-Year Production and Proved Reserves Call

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PRESENTATION

Operator

Good day and welcome to the Chesapeake Energy hosted conference call. Today's conference is being recorded. At this time I would like to turn the conference over to Mr. Jeff Mobley. Please go ahead, sir.

Jeff Mobley - *Chesapeake Energy - SVP of IR*

Good morning and thank you for joining our conference call today on short notice. Before I turn the call over to Aubrey and Marc, I need to provide you with disclosure concerning the forward-looking statements that Chesapeake's management will make during the course of this call. The statements that describe our beliefs, goals, expectations, projections or assumptions are considered forward-looking. Please note that the Company's actual results may differ from those contained in such forward-looking statements. Additional information concerning these statements is available in the Company's SEC filings. Aubrey?

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Aubrey McClendon - *Chesapeake Energy - CEO*

Thanks, Jeff, and good morning to each of you. I'd like to begin by introducing the other members of our management team who are on the call today. You've obviously heard from Jeff already. In addition, Marc Rowland, our CFO is here, and Mark Lester, our executive VP of Exploration. They are both with me in Oklahoma City this morning and Steve Dixon, our Chief Operating Officer, joins us from the road.

I'm going to begin with some operational comments and then going to ask Marc to address several of the inquiries that received about calculation of finding costs. We've already seen some wild, and we think erroneous, calculations of that and I think that largely stems from analyst's confusion about what the SEC requires as to revisions to proved estimates. So we will come back to that.

But I'd like to begin by saying this is the first time in many years that we've provided an operations update outside of our normal earnings press release. We decided to change this year because we noticed that many other companies are doing this these days and investors seem to like it. In addition, it's a better way for us to highlight the remarkable operational achievements that we delivered to shareholders in 2007. As a reminder a week from this morning at 9 AM Eastern Standard Time, we will hold another conference call to discuss our earnings press release which will be released at 4 PM Eastern Standard Time on February 21.

I hope you've had a chance to look through yesterday's press release. We provided 11 pages of what we believe is very helpful information about our Company. In particular I hope you will carefully study the table on page 5 and arrive at the same conclusion that we have that over the past 10 years, and especially the past five. Chesapeake has indeed won the Great Unconventional Land Grab and now owns the biggest upside inventory in the business of developing onshore natural gas. We believe this table holds the key to understanding how Chesapeake will continue its remarkable growth in per share net asset value for years if not decades to come.

In this release, there are some very significant numbers that I would like to highlight. First, our proved reserve growth. During the year, we increase our proved reserves from 9 tcf to 10.9 tcf, an increase of 21% in just one year and of course that comes after our sale of 200 bcfe on 12-31-'07 through our VPP.

Given what proved reserves are valued at these days, we believe that 2 tcf of added proved reserves would easily sell for \$7 billion to \$8 billion in the open market. That would represent approximately \$15 per share of net asset value growth in just one year and just from proved reserve growth. As I will discuss in a moment, the value of our unproved reserves increased very dramatically as well. I hope you'll remember that this time last year we predicted that we would get to 10 tcf proved reserves by year-end 2007. In fact, we did twice as well as originally planned.

Last fall we began to better understand what we could accomplish through the drillbit and predicted that at year-end 2008 we would be at 12.5 tcf to 13 tcf and at year-end 2009, we would be at 14 tcf to 15 tcf of proved reserves. However, after our 2007 performance, it sure seems like we should be able to achieve 15 tcf of proved reserves by year-end 2009. In doing so, we will be creating at least \$15 per share of net asset value in each of 2008 and 2009. And that is before likely further increases in the value of our unproved reserves and also from today's stronger natural gas prices.

I would also point out that all of our projected reserve growth will come from a large and diversified base of conventional and unconventional onshore gas plays in the U.S. that provide balance and are providing very predictable outcomes. Nothing else has to work for us, no acquisitions, no stealth plays, we just keep our heads down and keep drilling ahead on the acreage that we own.

Now let's talk about our unproved reserves. During the year our acreage inventory grew from 10.7 million net acres to 13.2 net million acres and our backlog of undrilled locations increased from 26,000 to 36,300. During the year we also acquired another

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3 million acres of 3-D seismic. Together this 32 million acres of leasehold and seismic are an unrivaled and unprecedented competitive advantage in our business and it therefore follows we should be able to continue delivering transparent and top-notch growth in the industry.

Through our 36,300 location backlog, we expect to be able to deliver 33 tcf of risked unproved reserves and perhaps a staggering total of 100 tcf of unrisked unproved reserves in the years ahead. By comparison at this time last year, our risked unproved reserves were 18 tcf, so we added 15 tcf this year of risked unproved reserves in addition to adding the two tcf of proved reserves.

So a good question might be, what is a risked unproved reserve worth these days? I think there are two ways to answer that, both of them are market-based approaches. The first is what do unproved reserves go for in the acquisitions market? Today we believe they go for at least \$0.75 to \$1 per mcf which would value our risked unproved reserves at \$25 billion to \$33 billion.

A second way to approach the value question is to ask, what does acreage go for these days? Well, one way to look at it is to say that we have 11 of our 13 million net acres have not yet been fully developed. For that to be worth \$25 billion to \$33 billion, our acreage would just need be worth somewhere between \$2,300 and \$3,000 per acre to reach that valuation. Well, how does that test out versus where our acreage is located? In the prime portion of the Urban Barnett play, for example, acreage is going for \$20,000 to \$25,000 per net acre. In the Fayetteville, \$10,000 to 15,000 per net acre and in the Woodford plays in Oklahoma, we just sold fringe acreage to a competitor for \$6,300 per net acre, and so on.

In fact you can just move down the table on page 5 and look at every play that we have and using either of my methodologies or if you prefer, you can just compare our acreage values to the implied values accorded other companies in the same plays for their acreage to their stock market valuations. After doing so, I believe you can easily confirm that our risked unproved reserves are likely worth at least \$25 billion to \$33 billion.

On top of that the PV-10 of our proved reserves at today's five-year strip price -- five-year strip gas prices is \$27 billion. I would point out that is a \$7 billion gain since 12-31 pricing, roughly \$14 a share just in the past six weeks. So the move in gas prices has been very dramatic not only in the front of the curve but also in the back of the curve.

We also believe the value of our non-E&P assets is about \$5 billion. So you can see that it's very easy to solve for at least \$60 billion as a reasonable enterprise value for Chesapeake. With about \$10 billion in debt, I believe we've built a company with \$50 billion of equity value and believe that we will certainly realize it and more in the years to come.

One last thing, please recall that now we can deliver all of this value creation without adding debt or increasing our share count. In closing, you have my personal commitment that it's my goal to deliver at least \$15 per share of shareholder value every year for years to come. Sometimes I'm asked why I buy so much Chesapeake stock on the open market. The answer is in the table on page 5 and in the math that I just gave you.

I would like to now have Marc to address the findings cost questions that have come up today.

Marc Rowland - Chesapeake Energy - EVP and CFO

Thank you, Aubrey, and good morning to everyone. I have a very brief comment. In these huge unconventional plays that we, and others, are in we are booking substantial additional reserves as performance revisions as we believe is the convention and the SEC's preferred methodology in the industry. These revisions are from reserved increases within existing spacing units. They may be proved developed or proved undeveloped. In our case in 2007, all but 138 bcf equivalent of our 1,248 bcf equivalent or 1.2 tcf of positive revisions where of this nature.

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These cannot or should not as the SEC has affirmed be considered as extensions or discoveries because nothing from the existing field unit was extended and nothing new was discovered. We, and others, in fact know that the reserves are there and as we increase the density or change the spacing or move the offsets from 2,000 to 1,000 feet, we believe and in fact the SEC has suggested that these should be considered to be performance revisions.

We have seen some analysis from reporters somehow questioning this methodology for us and Anadarko's results as well and complementing other methodologies when, in fact, the SEC themselves has recently disclosed questioned the other methodology. So we would encourage folks to look back and analyze our performance revisions and our extension and discoveries as one and the same and please use that methodology in calculating your finding costs.

Aubrey McClendon - *Chesapeake Energy - CEO*

With that, we're available for questions. Thank you.

QUESTIONS AND ANSWERS

Operator

Thank you. (OPERATOR INSTRUCTIONS) David Tameron, Wachovia.

David Tameron - *Wachovia Capital Markets - Analyst*

Good morning. Congratulations on some strong year-end numbers.

Aubrey McClendon - *Chesapeake Energy - CEO*

Thank you, David.

David Tameron - *Wachovia Capital Markets - Analyst*

Can you talk a little bit about the Fayetteville? You increased your acreage position it looks like. Can you talk about what you are seeing as far as results?

Aubrey McClendon - *Chesapeake Energy - CEO*

Yes, I guess I've seen one comment that perhaps the increase in our acreage was from stretching the boundaries of the core area. In fact, we use the exact same box that Southwestern uses as we believe, a, it's accurate and b, it's accepted by investors as defining the productive area of the Fayetteville. And our acreage went up to 585,000 acres in that play. And we just were able in the fourth quarter of 2007 to make a number of transactions that were well below the radar screen and at prices well south of the \$10,000 and above numbers that we've seen from other companies that were late to the play and are just now trying to scramble and can get in.

So we like what we've seen, as you've seen from our table. We believe that we can drill on a risked basis about 5,700 wells averaging about \$3 million in cost and find about 2 bcf. Our average net revenue interest there is about 85% so that is pretty strong. And we booked 335 bcf approved reserves and believe that we have 9.3 tcf of risked unproved reserves and perhaps as much as 22 tcf of unrisked.

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So we like the play. We have 11 rigs there running right now and I believe our goal by the end of 2008 will be to increase that number to about 20 rigs. It's a terrific play and of course, we as we always do, congratulate Southwestern for discovering it and at the same time congratulate our land teams for coming in second-place and scoping up 585,000 acres at a very attractive price, well south of \$1,000 an acre on average.

David Tameron - Wachovia Capital Markets - Analyst

All right, good, thanks. And then can you give me -- one more question and I will jump off. It looks like reserves as a component of your overall adds -- I'm sorry -- acquisitions as a component of your overall reserve adds was less than 15%. So not a big chunk there. Can you tell me production year-over-year if you look fourth-quarter to fourth-quarter, how much of that is acquisition, how much of that is drillbit?

Aubrey McClendon - Chesapeake Energy - CEO

Very little of it is acquisition, the proved reserves that we booked related to acquisitions would basically be the PUDs from acreage. As we've stated, David, we are just not in the PDP acquisition game and so don't have the exact number but it is really de minimus.

I would like to go back to the first part of your question to just remind you that I think if our Fayetteville division was a stand-alone company, people would have no problem saying that acreage is worth at least \$10,000 an acre and in fact make the argument that it's worth north of that.

So I think it comes back to the challenge here and I think the opportunity for investors is to realize what the sum of the parts is here. And we believe our Fayetteville business unit is worth somewhere from \$6 billion to \$9 billion. And I think if it were a stand-alone company, kind of side-by-side with say Southwestern, that is the kind of valuation you would give it. And my suspicion is that that's not being afforded that inside our company but I think that as our results continue to roll in from this very exceptional play that that will certainly be realized over time. Thanks for your question.

Operator

Jeff Robertson, Lehman Brothers.

Jeff Robertson - Lehman Brothers - Analyst

Good morning, Aubrey, can you talk a little bit about how you think about returns across all these different plays in the context of allocating capital between very large positions and a bunch of -- and in a lot of different places?

Aubrey McClendon - Chesapeake Energy - CEO

Sure, Jeff. As you know, you followed our Company for a long time and we pride ourselves on being dynamic and also on being responsive to changes. And so our budget changes once a month and I don't know how many other companies in the business modify their budget once per month. But we do that because we are on a very real time. Of course we are collecting more information about plays in the U.S. than anybody else and so we feel like we have insights into plays. And we can make adjustments along the way.

So we rate plays both on their internal rate of return numbers and we rate them on finding cost numbers and we also rate them on ultimate upside capability and then provide the capital accordingly. Just to give you an idea, the Barnett Shale, it's obviously our number one play and of course it is a play that if we were to just spend money on that particular play this year, it alone

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could replace our reserves and hold our production steady if not to go up a little bit. The returns there are exceptional and as a consequence, we are allocating about 25% to 30% of our total capital expenditures to the Barnett.

The second play is the Fayetteville. We will spend about \$500 million in the Fayetteville this year drilling wells. Third play is Sahara, about \$225 million in Sahara and it goes on down from there. So those are the Big Three and when you add those three up they add to just under 50% of our total CapEx will be spent in those three big unconventional plays.

Jeff Robertson - *Lehman Brothers - Analyst*

In the Barnett, Aubrey, with the -- now that you've been drilling on that airport lease since I think May of last year, and have moved rigs to the south end of the airport, what have you learned about that lease?

Aubrey McClendon - *Chesapeake Energy - CEO*

We've learned that it's a good lease and we are thrilled to have it. We are meeting our pro forma for that area. In fact, we are exceeding it. Our pro forma is 2.65 bcfe for Core acreage and Tier 1 acreage and I believe the last numbers I saw there we were running 2.7 or 2.8. Our newest well which is on the east side of the -- sorry -- the west side of the airport, just came in about 7 million a day and it is our best well from the airport.

So certainly a monster well by anyone's definition and we believe that since we're only about 20% of the way to the drilling here that we've got a long ways to go and are very excited about what we are finding. And of course we are able to use this base of acreage to also leverage off into surrounding neighborhoods so the 18,000 acre lease over time will in fact grow to somewhere between 25,000 to 30,000 acres when you consider offsetting lands.

Jeff Robertson - *Lehman Brothers - Analyst*

That is by turning outward from the airport and drilling from the airport?

Aubrey McClendon - *Chesapeake Energy - CEO*

Yes.

Jeff Robertson - *Lehman Brothers - Analyst*

Okay. And then lastly if I can, on the emerging plays and also in Appalachia, can you talk about where you expect to learn the most of what you call your emerging plays in 2008? And outline a little bit the progress you envision for the Marcellus?

Aubrey McClendon - *Chesapeake Energy - CEO*

Well, we've been focused on the Marcellus for several years. I guess we've been more tight lipped about it than, perhaps, other companies and that is really characteristic of us because we would rather control all the acreage first before we start divulging results from our activities. So I know there's been a lot of excitement about what some other companies have put together in the Marcellus but we like for people to recognize that we have over 1 million acres in the Marcellus fairway from Southern New York through Pennsylvania down to Northern West Virginia.

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So, we started to drill there. We've been drilling for over a year. We've drilled horizontal wells, we've drilled vertical wells and we are still in the acreage game and pleased by what we are seeing and of course love gas prices in that part of the country as well.

The emerging unconventional, our whole range of new plays that we have going, we will not discuss today. But I would like to remind you, Jeff and other folks, of course that Chesapeake sees more shale every day than any other company in the world. From those activities we get new ideas. We have built a proprietary laboratory here in Oklahoma City to evaluate shale cores and to model certain frac job results on those shales. And we do believe that that laboratory which employs about 20 professionals, that are petrophysicists and other experts in rock and rock mechanics, does give us a proprietary advantage, a competitive advantage over other companies.

So our job is to continue to find new plays. We are experimenting in various new plays across the country and as we have success in those plays and as we have locked all the acreage that we intend to lock up, we will be forthcoming about those.

Jeff Robertson - *Lehman Brothers - Analyst*

Thank you.

Operator

Scott Hanold, RBC Capital Markets.

Scott Hanold - *RBC Capital Markets - Analyst*

Good morning. Aubrey, can you talk about your outlook for growth? I think in '09 you're looking at somewhere around 10% to 15% growth and you are operating 145 rigs now. When you kind of look out over the next two to three years, where do you see your operated rig count moving to sort of sustain a 10% to 15% type of growth rate?

Aubrey McClendon - *Chesapeake Energy - CEO*

Well, right now we're modeling growth in those categories but of course -- we're in those years, of that amount. But you'll see our official guidance will come out a week from yesterday afternoon. So I'm not going to comment much about that. But I will say that we increased our production this year by over 500 million a day and we started off the year thinking we could increase it by about 200 million a day. So we've --

Marc Rowland - *Chesapeake Energy - EVP and CFO*

And that is just from January to December. That is not a year-over-year.

Aubrey McClendon - *Chesapeake Energy - CEO*

Good point, thanks, Marc. So as a consequence, my hope is that we continue our long-time practice of under-promising and over-delivering and I think it's likely to occur here. So from a maintenance number, I will tell you that the only thing we need to have is 40 rigs running in the Barnett and that holds everything constant. So we kind of look at it as we have 100 rigs to drill on and 40 rigs that keep the company constant.

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So as some of these new plays develop though, we will have to add a few rigs and we will look to that but again, the basic parameters for us will be to make sure that we develop the acreage that we own and that we stay in a cash neutral position and that is our commitment so that all this growth comes down into per-share growth rather than just general corporate growth.

Scott Hanold - RBC Capital Markets - Analyst

Okay, fair enough. And moving back to some of the emerging shale plays, on the Delaware Basin, is there any specific color you can give on that play or where you are at there? I noticed, sort of, if you look at the trend over the last several updates you guys provided, I guess the well costs have ratcheted up from \$4.5 million to \$5.5 million to I think \$6.5 million in the latest update. Can you kind of give us a sense of what needs to happen to make that play productive? Is it improving IP rates and production rates and/or is it really controlling the cost side of it?

Aubrey McClendon - Chesapeake Energy - CEO

Well, first of all, we have a very large acreage position there, 815,000 acres and about 1 point on a net basis, about 1.5 million acres on a gross basis. And we are shooting about 1 million acres of 3-D across it. So I think as we've discussed in the past, we are increasingly optimistic about being close to crossing the commerciality curve on the shales. It's likely to occur through vertical Barnett wells with a horizontal lateral into the Woodford. And the reason that our costs are at \$6.5 million rather than \$4.5 million is we've now gone to this modified approach where you drill and complete a horizontal well in the Woodford and then complete vertically in the Barnett.

So I can't say that we've completely cracked the code there but we are close and I think, in addition, there are other possibilities in that area for other plays and we will continue to work on those. But right now we continue to inch closer to having the play work. We've recently drilled a series of wells that are encouraging from the reserve side and continue to work on the cost side as well.

Scott Hanold - RBC Capital Markets - Analyst

Okay, is there Bone Springs potential out there on your acreage?

Aubrey McClendon - Chesapeake Energy - CEO

There is potential across the acreage from a wide variety of formations.

Scott Hanold - RBC Capital Markets - Analyst

Okay, fair enough. And back to the Fayetteville acreage, I guess you all indicated you did pick up some acreage here in the fourth quarter. It looks like a pretty good chunk. Is there any color you can give as far as how you are able to lock up additional acres in the play at such a good cost? Is it -- was it through leasing sales or was it just based on just an aggressive land effort out there?

Aubrey McClendon - Chesapeake Energy - CEO

Well I think several things. First of all, we've been in the play since January of 2005 with Landmen and so we've had over 200 Landmen in the field every day for three years. And so we now have a base of land ownership information that could only be ceded by Southwestern. So we know where the bodies are buried, so to speak, and we continue to pick up a lot of acreage off

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the ground that other companies can't because they just don't know who owns them. And so they are stuck with having to buy big chunks from public auctions.

The other thing is really before a couple of other companies showed up late last year, Southwestern I think had most of what they wanted and we were out there hovering up a lot of 20,000 and 30,000 and 40,000 acre chunks at some pretty attractive prices relative to what happened at the end of the year and what has happened so far this year. And I think we've taken some criticism in the past for being early on buying acreage but I think when you see that in the Fayetteville we have 585,000 acres for a cost of under \$500 million and I think we could sell it today for \$6 billion, \$7 billion, \$8 billion, I think it certainly justifies being there early.

So -- and I would say that about all plays. I mean today we have 3,000 Landmen in the field buying new acreage every day. It costs us \$1.5 million a day keeping those guys in the field. But the information that comes back from that -- from those efforts in the field does provide us with a proprietary advantage to buy acreage cheap. And then if we want to we can sell it for more. We just sold some Woodford acreage we weren't crazy about and we sold it for 12 times what we paid for it.

So we can do that in numerous plays across the company if we would like to. Right now in most of our plays we'd prefer to drill wells rather than sell acreage, but it's always a possibility particularly in an industry that, I think, is increasingly constrained with new ideas and some companies perhaps got left out of the land grab and now have to buy their way in at some pretty high prices.

Scott Hanold - RBC Capital Markets - Analyst

Okay, fair enough and one last question real quickly here. Any perspective on the political bantering that's going on regarding severance taxes in Arkansas?

Aubrey McClendon - Chesapeake Energy - CEO

You know we are involved in that discussion and we are working with Southwestern and other companies that are active in Arkansas and I'm certain we'll arrive at a compromise that fits both the needs of the people of Arkansas, as well as keeps drilling in Arkansas competitive with what other states are doing. I would remind you that the type of wells that we drill in Arkansas, horizontal wells, are today exempt from severance taxes in Texas and in Oklahoma and so Arkansas needs, of course, to keep that in mind.

Scott Hanold - RBC Capital Markets - Analyst

Thank you.

Operator

Joe Allman, JPMorgan.

Joe Allman - JPMorgan - Analyst

Good morning, everybody. Marc, just curious what you're seeing in terms of the trends here for drilling and completion costs recently?

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Marc Rowland - Chesapeake Energy - EVP and CFO

Yes, Joe, good morning. The trends have been continued competition and softness. The drilling rig prices have leveled out a little bit more although I would say that a few hundred dollars a day each time we hit a rig is what we expect as a discount from the previous cost. There are still some new rigs coming on the market although we've essentially taken delivery or soon will of all our 81 rigs that we operate.

What we are seeing is in certain plays some frac cost reductions that are pretty substantial. We talked earlier in the year about the numerous competitors that have been added into the Barnett Shale which of course is all requires stimulation as most of the unconventional plays require substantial numbers of fracs. Recently in the Fayetteville, we were seeing some pretty substantial reductions as well as equipment gets moved into that area.

So the trend is for slightly softer costs and that is pretty much what we projected throughout 2007 and I'd say in '08, we are using flat costs for our modeling purposes, our internal expectations would be probably to see a 5% to 10% reduction from this point in time through the end of '08.

Aubrey McClendon - Chesapeake Energy - CEO

Joe, we've been in -- and this follows up on what we've said in the past about we think this is a golden age of value creation for companies that have locked down their acreage costs and now can work basically through a manufacturing outlook to drive those costs lower. So unit costs are coming down, efficiencies are going up and gas prices are going up. And so I think that investors are going to be very surprised by the amount of value creation that is occurring.

Which kind of brings me to my next comment. We, with all due respect, just think you are wrong in your criticism of Anadarko and Chesapeake for the way that we report our reserve changes. And would really ask you to go back to the SEC regulations and also their commentary and we and Anadarko believed that absolutely we are reporting revisions and extensions and changes to proved estimates -- of existing proved estimates absolutely correctly. And we will going forward as we have in the past, say how much of our revisions are related to what I think you are thinking about which is wells that have changed in their performance in the past year and for us that was 138 bcfe.

But if you are to take our revisions to existing estimates and not give us credit for that and then calculate finding costs, you are going to come up with a \$4 number, but it's wrong because we've spent a lot of capital to go develop those reserves that are in that revisions to previous estimates. So I'd really ask you to go back to the drawing board on your analysis of that situation.

Marc Rowland - Chesapeake Energy - EVP and CFO

Yes, Joe, said another way, if we took our well set that existed at 12-31 of 2006, and we did nothing but look at the reserves plus the production during 2007, that in fact was a positive revision as we think it should be by being conservative, that was a revision on that well set of 138 bcf. But that is not the end of the question. You can't then simply say everything else is an extension and a discovery. If you are within spacing units, it is very clear and it's very accepted in the industry and in fact we don't know of any other way to do it, to consider additional reserved increases that weren't previously booked in those units to be not extensions and discoveries. And so we don't get where you are coming from at all and as Aubrey said and I confirm my opinion, I think you are just wrong.

Joe Allman - JPMorgan - Analyst

I appreciate that. And I think it's debatable whether you put in revisions or extensions and discoveries --

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Marc Rowland - Chesapeake Energy - EVP and CFO

No it's not.

Aubrey McClendon - Chesapeake Energy - CEO

No it is not debatable, Joe.

Joe Allman - JPMorgan - Analyst

But the SEC -- one problem that some operators have is the SEC making rules by comment letter and so -- and that is what they seem to be doing. And so --

Aubrey McClendon - Chesapeake Energy - CEO

Well we think comment letters have quite a bit of authority and we pay attention to them and don't believe you have the discretion of just ignoring comment letters.

Marc Rowland - Chesapeake Energy - EVP and CFO

But the fact is that we and most others were doing it this way before the SEC had ever commented --

Aubrey McClendon - Chesapeake Energy - CEO

We've been doing this for three to four years, Joe.

Joe Allman - JPMorgan - Analyst

So all we are asking is just breaking things out more, whether it's in revisions or in extensions, just a better breakout. I mean that is all we are asking.

Aubrey McClendon - Chesapeake Energy - CEO

That is not what you've asked Anadarko to do and what you've asked us to do when you make your calculations. And we have done that and we've done it in the past and we will continue to do it going forward but we --

Marc Rowland - Chesapeake Energy - EVP and CFO

We've done it on this call, so we've told you what the numbers are.

Joe Allman - JPMorgan - Analyst

I appreciate that. I think our finding cost calculation is more on the cost side than in the reserves side and --

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Aubrey McClendon - Chesapeake Energy - CEO

Let's talk about that for a minute. Let's say that you are following a company that drilled one well in the Barnett Shale and spent \$2 million to find 2 bcfe. And let's say they also went and spent \$100 million of acreage for acreage in the Fayetteville. Under your methodology, the company would report that its finding costs were \$1 an mcf; it spent \$2 million and it found 2 bcfe and that is what it would consider to be accurate information to its investors about what its finding costs were in that Barnett Shale well.

You on the other hand, would add the \$100 million in with the \$2 million and arrive at the conclusion that the Company's finding costs were \$100,000 per Mcfe and that is basically what you have done by piling in our cost pool acreage for which we have booked no reserves and said that that is an accurate cost as to what it is costing us to develop existing reserves through the drill bit. That number is \$2.08 per Mcfe, not \$3.50 or \$4 as you and few others have calculated.

It's really important to be able to distinguish leasehold and acquisitions that are for acreage on which we have booked no reserves as contrasted with expenditures that we make to drill wells and develop new reserves of natural gas and oil.

Joe Allman - JPMorgan - Analyst

I appreciate that and I think at some point you do have to count that cost as a cost to finding and fully developing reserves and that is what we're trying to capture. And so like if you never count that, then that is not quite accurate and I'm sure you would agree with that. Of course, I think like a three-year average or a five-year average is better -- because then you do a better matching of costs and reserved adds, but at some point you do need to count those costs in your final cost calculation.

Marc Rowland - Chesapeake Energy - EVP and CFO

There is a methodology for that and it's called the full cost pool and we transfer the acreage as we drill the wells and evaluate reserves that result from that. And that's all-in, seismic, acreage, --

Unidentified Company Representative

Overhead --

Marc Rowland - Chesapeake Energy - EVP and CFO

-- overhead, capitalized interest and drilling cost, completion cost, hookup cost and that is our depreciation rate. And so if you want to look over the entire company's of acquiring stuff from 1999 forward, you know our depreciation rate is that \$2.65 era and that includes all those costs. So it's not like we'd don't ever account for them. That is how they get accounted for and that is the accounting methodology of how you account for them.

Joe Allman - JPMorgan - Analyst

I appreciate that. And Marc, just that 138 bcf, is that -- just to be clear, is that the performance related revisions that is not related to future infill locations?

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Marc Rowland - Chesapeake Energy - EVP and CFO

That is the performance related revisions using the reserves in existence and booked as proved at 12-31-06. If you take any new drilling locations -- and just to be clear -- some of the performance revisions are on new wells that are actually drilled, they are not all proved undeveloped. Many of them are proved developed.

Joe Allman - JPMorgan - Analyst

I understand. I appreciate that. All right, guys, I appreciate your time.

Operator

Shannon Nome, Deutsche Bank.

Shannon Nome - Deutsche Bank - Analyst

Thanks, good morning. Trying to get a fix on efficiency gains in the Barnett Shale. And you've got in your table here you are going to run or you are running 39 operated rigs. Can you just fill in like three other blanks which would be your average operated well count last year and then how the well count will change based on that? And I'm sensing that a lot of the operators in the Barnett are going to have a flattish rig count year-to-year but you are going to squeeze some more wells out of that. And I'm just trying to figure out what that ratio looks like.

Aubrey McClendon - Chesapeake Energy - CEO

Yes, let's see. I don't know -- I think we may be able to get you an average from last year. Let's see. I don't have the exact number, Shannon, but I believe the number would have been around 30 or so maybe as high as 32 or 33. We've been at 39, 38 to 40, we've been there for what, Marc, the last four or five months probably? We probably got to full speed there sometime in the third quarter of 2007.

Shannon Nome - Deutsche Bank - Analyst

And that is where you are going to sit for the year?

Aubrey McClendon - Chesapeake Energy - CEO

Oh I think so. It might inch up a little bit but in terms of efficiencies, you are absolutely right. Our days to drill out there have been, say it again -- yes, we are at 25 days in our budget between spuds right now and if I recall from last year, we were using a 30 number. So I think we are at least 15% more efficient than we were last year. I also believe that our cost of drilling has continued to come down as well.

So it's really a remarkable play, and I know you know this, but I want to remind you again that we are only capturing or producing or developing about 20% of the gas in place. So I really think this will be a play that like again some of our other shale plays that for really decades we will be finding out how to increase the amount of production we get from this shale. It has been pointed out to me that we are projecting to drill this year 581 gross wells and 505 net wells. And again, I believe those numbers are up about 15% from last year.

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Shannon Nome - *Deutsche Bank - Analyst*

The follow-up then would be, especially in context of what you highlighted earlier, that the gas prices started to perk up here. The production data we get from the EIA does lag some but how would you, I guess, triangulate from the stuff you had and others have had in the efficiency gains relative to what you expect for supply growth in gas prices this year. Are you changing your hedging philosophy based on any change in your gas price views?

Aubrey McClendon - *Chesapeake Energy - CEO*

Well, we will show you our hedging next week but we anticipate some exceptionally strong domestic growth figures this year probably in the 5% range as much as 3 bcf a day of increased production and we will be one of the leaders in as we were last year. Offsetting -- by the way that is onshore. Offsetting that will be some offshore declines, as much as half a Bcf to 1 Bcf from Canada.

And of course, what we are all watching unfold across the world are rising energy prices that are putting a floor underneath gas prices that I don't think anyone counted on which is I think people did not completely understand the world's need for natural gas. And so our view is that what will balance the market this year will be demand which will be at least a bcf a day higher from electrical generation if not from other areas of demand whether it be fertilizer or ethanol or other industries. And at the same time, we think we will see far less LNG hit the shores of the U.S. than last year.

So you will see that we maintain a pretty defensive posture for the next couple of years that will always be the company's hedging strategy because we are long, as you can see, a lot of gas here. So we will play it pretty cautiously on a rolling two-year basis. But I for one personally think that people will be actually quite pleasantly surprised by what natural gas prices do in the next couple of years. And they will still be a bargain relative to other Btu's.

And you know this well, but what has happened the past month in coal prices around the world is nothing short of remarkable. You are seeing coal plants today, before emissions, credit costs pushing the \$7 number on breakeven cost. So I think that has put a real solid floor underneath summer gas prices. You know, and the stocks just don't reflect it.

When our PV-10 goes up \$14 a share between 12-31-07 and now, in just six weeks, it really I think highlights the leverage that -- the enormous leverage that we have to what is happening in the back of the curve. Last night I noticed that 2013 gas prices are now ahead of 2010 gas prices. And this Contango phenomenon that has now developed has been something we've been talking about for years, which is there is no reason why gas prices in the out-years should be below present gas prices, particularly in a world where carbon is going to have a cost.

And I think more and more, natural gas will be seen as the fuel that can solve our environmental issues and also meet our energy challenges, particularly with regard to its main competitors, coal and oil. So we're very excited to own as many natural gas reserves as we have, and think people are going to really benefit by investing alongside us.

Shannon Nome - *Deutsche Bank - Analyst*

Very much agree. I will let someone else get on, but before I get off, one more on monetizations. Anything else on the horizon on the upstream VPP front, or is there anything new on that to report?

Marc Rowland - *Chesapeake Energy - EVP and CFO*

Shannon, progress continues. We are preparing a couple of more packages that will soon be marketed on the VPP side. It looks like \$650 million plus or minus is likely within the next 60 days on those, given our expectations of future gas prices. And these

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would be similar reserves to what we've done in the past; very long life, stable, really no development left for us and just a pricing play. It is our expectation that those will be treated as sales for accounting purposes.

Then on the midstream side we are making great progress. We're in the middle of negotiations with numerous parties. It's a project that is being very well-received, and we wouldn't be surprised to see something within the next several months that would suggest a value of \$3.5 billion to \$4.5 billion for our midstream assets.

Aubrey McClendon - *Chesapeake Energy - CEO*

And this is a business in which we have invested to date about \$800 million, and we would guess it has no value in our present stock market valuation, but I think you'll see us be able to put a valuation the way the market's described at perhaps as much as \$8 a share.

Shannon Nome - *Deutsche Bank - Analyst*

Excellent, thank you.

Operator

Tom Gardner, Simmons & Company.

Tom Gardner - *Simmons & Co. - Analyst*

Good morning, guys. Aubrey, obviously you all have an impressive inventory of resource play acreage. In general, do you have a clear path facing the lease maintenance challenge that goes along with that? And then kind of tagging onto David's questions about the Fayetteville, you mentioned 20 rigs in '08. In helping us kind of model out the potential shareholder value, where do you see rig count peaking? I know it's a forward-looking question.

Aubrey McClendon - *Chesapeake Energy - CEO*

Rig count for the Fayetteville or the Company or what?

Tom Gardner - *Simmons & Co. - Analyst*

The Fayetteville.

Aubrey McClendon - *Chesapeake Energy - CEO*

You know, really don't know the answer to that. But right now, I think we plan to get to 20 by the end of the year, and I want to make sure we are clear on that, that it is not an average for the year. That is our goal by the end of the year. We do model in all of our plays how many rigs it takes to HVP our acreage, and we monitor that very closely. And I will just tell you that at the present rate of drilling, we are not aware of a play that we are involved in that we are not going to get to acreage.

And if we ever find ourselves in that kind of a situation, we will be happy to bring a partner in or sell some acreage off to somebody else who is a little more acreage short than we are.

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Tom Gardner - *Simmons & Co. - Analyst*

That is good news. And then moving onto the Barnett with 39 rigs running as Shannon brought to bear, clearly the most active driller in the play. And some of your competitors have called into question the ability of any operator to execute without encountering infrastructure or bottlenecks with that kind of activity in the area. Can you speak to how well you are doing, how well Chesapeake is doing in keeping ahead of the --?

Aubrey McClendon - *Chesapeake Energy - CEO*

I remember when some of my competitors didn't think we could run one rig back in 1989 when Tom and I first started. So that is not an uncommon criticism, I suppose. But I would just point you to the results. Look at our production in the Barnett; we are now up to 410 million a day, our Barnett production increased -- Jeff, help me out here.

Jeff Mobley - *Chesapeake Energy - SVP of IR*

(technical difficulty) basis for the year, it increased 140%.

Aubrey McClendon - *Chesapeake Energy - CEO*

Yes. So our production was up 24% on a sequential basis, up 134% year-over-year. So you can question whether or not we can do it or you can look at the company's results and sit back and say I'm pretty impressed with what they've done. You can't do what we do in Fort Worth and not have a big staff. We have dozens and dozens of community affairs and government relations people on the ground. We have over 300 right-of-way agents in the field everyday. You can't do this unless you have put the entire strength of the company's resources, both human and financial to bear on the problem. And I think one of the things we are particularly proud about is we've gone into other companies' hometown and we've dominated the play inside of Fort Worth. I can guarantee you that would never happen in Oklahoma City, Oklahoma.

So the way we approach things though is from a very intensive land and community affairs basis and there are challenges every day, regulatory, legal, but at the same time, we are continuing to acquire as many as 10,000 leases a month. And so the great majority of people in Tarrant County and Northern Johnson and Western Dallas are responding affirmatively to what we are doing and are signing up and asking us to drill wells underneath them.

I'm actually quite pleased that some other companies are competing with us in Greater Fort Worth because I think it does help bring more companies to get focused on the challenges of drilling in an urban environment. If it were easy, somebody else would have done it, so we are thrilled that it's difficult. We like to take on challenges particularly on the land side.

Tom Gardner - *Simmons & Co. - Analyst*

Thank you, very helpful. I will let someone else get on.

Operator

Michael Hall, Stifel Nicolaus.

Michael Hall - *Stifel Nicolaus - Analyst*

Thanks. I guess just a little more on the Fayetteville. I'm looking at risked unproved reserves there per acre basis, clearly your acreage went up there but it looks like that kind of a reserve per acre went up quite a bit as well. Your per well targets haven't

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gone up though so clearly it may be some de-risking going on there. Just wanted to maybe talk a bit more about that if you could.

Aubrey McClendon - *Chesapeake Energy - CEO*

It's really, that's the short answer, that's all it is.

Michael Hall - *Stifel Nicolaus - Analyst*

That's all it is.

Aubrey McClendon - *Chesapeake Energy - CEO*

-- is reduced risked factor nowadays, we are at risking our acreage 20% in the core area and, Jeff, before, we would have been 40% or 50% probably in that core --

Jeff Mobley - *Chesapeake Energy - SVP of IR*

I don't remember the prior quarter, but middle of last year I know it was 50%.

Aubrey McClendon - *Chesapeake Energy - CEO*

So we've -- just as results have rolled in we now drilled over 140 horizontal wells, our production is 120 million a day on a gross basis and the results justify the de-risking and of course, we are in 80% of Southwestern's wells also so we get that information base also. And Jeff just pointed out to me last year or last quarter, rather, our risk factor was 40%. We've reduced it to 20%.

Michael Hall - *Stifel Nicolaus - Analyst*

Okay, sounds fair. In terms of in the Marcellus, any chance you could maybe give us some thoughts on when you think you might be able to discuss horizontal development opportunity there?

Aubrey McClendon - *Chesapeake Energy - CEO*

Yes, I think it will be later.

Michael Hall - *Stifel Nicolaus - Analyst*

Any more color there?

Aubrey McClendon - *Chesapeake Energy - CEO*

No, that's as helpful as I can be.

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Michael Hall - *Stifel Nicolaus - Analyst*

Fair enough. And what about infrastructure constraints in Appalachia? People talk about the pretty big growth there in infrastructure in terms of particularly water as you keep coming in with these shale plays, isn't really discussed. Care to talk about that?

Aubrey McClendon - *Chesapeake Energy - CEO*

Sure, I don't know how much time you spent in West Virginia or Pennsylvania but they -- there are a lot of trees and a lot of hills and certainly it's not something that we can mow down like you could say in Johnson County. So there are going to be substantial infrastructure challenges there, service company infrastructure is an issue, gas pipeline infrastructure and just frankly physical infrastructure of getting there.

So I think these are all constraints that will keep the Marcellus from expanding quite as rapidly as the Barnett. And I would think it would develop more along the lines of the Fayetteville where you are four years into the play. If I'm not mistaken, I think Southwestern has around 20 rigs and we have 11 and probably the rest of the industry has 8 or 9. And so you are really at a 40 rig play and it's an exceptional play and the only thing that is holding it back is capital constraints with some companies and logistical and infrastructure challenges. And I think you will see that in the Marcellus as well.

The nice thing is you can get pretty long lease terms there and today in the Barnett you really can't get a lease longer than two years. But we still believe that five and 10 year leases can be had in the Marcellus. So that will help us out quite a bit. We will tell you that in Appalachia generally, we intend to drill about 50 horizontals and that will be to a combination target, Lower Huron, Marcellus, Devonian, and also Trenton Black River. So lots of exciting things going on in Appalachia and we just are not ready to be chatty about it as there is still some acreage in play that we are interested in capturing.

Michael Hall - *Stifel Nicolaus - Analyst*

All right. Sounds good. One last maintenance question, do you all have a future development cost number with your new PV-10?

Aubrey McClendon - *Chesapeake Energy - CEO*

Sure we do. When you say our new PV-10, our PV-10 --

Michael Hall - *Stifel Nicolaus - Analyst*

Well, PV-10 --

Aubrey McClendon - *Chesapeake Energy - CEO*

The \$20.6 billion in the press release?

Michael Hall - *Stifel Nicolaus - Analyst*

Exactly, yes.

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Aubrey McClendon - Chesapeake Energy - CEO

Yes, we've got that.

Marc Rowland - Chesapeake Energy - EVP and CFO

It's in the release itself.

Michael Hall - Stifel Nicolaus - Analyst

Oh, is it? I'm sorry.

Marc Rowland - Chesapeake Energy - EVP and CFO

Under the table that shows you what -- I think what the development costs are. Maybe it's not. We've got it right here. I will be happy to tell you what it is. Yes, the equity investment is -- \$7.3 billion.

Michael Hall - Stifel Nicolaus - Analyst

Great, thanks. Great, quarter.

Operator

Kurt Hiler, Adage Capital.

Kurt Hiler - Adage Capital - Analyst

Hi guys. Just a question on your acreage. You know you have probably 50 or close to 50% of your acreage has really not a lot of reserves booked with it. And you know presumably you have years and years and years of drilling locations it sounds like. At the same time, you continue to spend a lot on acreage, probably spent 25% or 30% of your total capital this year on acreage and I think Aubrey you were saying you are spending -- or have 3,000 Landmen out there -- costs a lot of money obviously.

I'm just curious is there a point in time where you have enough and we won't see a big expenditure on acreage in a year?

Aubrey McClendon - Chesapeake Energy - CEO

Well, it's kind of funny, when you look at companies that don't have much acreage, you always are excited when they acquire acreage and sometimes people look at us and say we've got enough. And my view is we had enough before we got in the Barnett three years ago and some companies said they had enough and didn't need to get in the Barnett. I'm pretty happy we're in the Barnett right now. And I am glad we decided three years ago we didn't have enough. I'm glad that we decided to jump in the Fayetteville already although we were already in the Barnett. I'm happy that we bought a bunch of acreage in the Fayetteville in late 2007 for \$3,000 an acre and today other companies are having to pay \$10,000 to \$15,000 for the same acreage.

I've never been a fan of the Arkoma Woodford but I'm glad we bought a bunch of acreage for \$500 an acre and were able to sell it for \$6,300 an acre. And I am thrilled that we are in the Marcellus even though by the definition of do you really need to be there, if you define that as do you have enough to do right now? The answer is well sure by that definition. But I'm paid and

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everybody in this room is paid to generate the highest risk-adjusted returns to shareholders. And it is our view that we need to continue to be investing in the future even if it dampens present returns.

We know that what these 3,000 Landmen are doing every day is buying acreage for X that almost immediately is worth 3 to 5 X if we wanted to turn around and sell it to our competitors who either do not have the desire or do not have the ability to have the land acquisition network as fully built out as we have.

So there's lots of ways to create value in the business and of course the primary way is converting undeveloped acreage to PDP reserves and we think we are as good as anybody else in the business at doing that. But there is another way as well which is to develop new plays and to acquire the leasehold early and then sit back and watch the world come to you with checkbooks willing to pay you 10, 15, 20 times what you paid for it. And we will continue to do that.

Kurt Hiler - *Adage Capital - Analyst*

Okay, so if I can just follow along with that. In terms of actually what you just said and then what you were talking about at the beginning of the call in terms of the -- I think the value numbers you were getting to at the beginning of the call were probably something along the lines of \$100 a share in value between your proved reserves and your market value of your unrisks -- or your risks nonproved reserves.

Aubrey McClendon - *Chesapeake Energy - CEO*

I think it is closer to 90 but -- (multiple speakers)

Kurt Hiler - *Adage Capital - Analyst*

Well, big number either way. You know you are doing some stuff to sort of attempt to accelerate the value there I guess with the VPPs and I guess if you can accomplish this midstream acquisition for \$3.5 million to \$4.5 million, I don't think there is any way that that is being reflected in the stock. But do you consider other more aggressive ways of realizing that value sooner than just over the next 10 years or something?

Aubrey McClendon - *Chesapeake Energy - CEO*

Well, I mean I think the only way you could do it is to say you're going to split the company up and have a bunch of single play companies which investors have tended to demonstrate to the valuations they put on these companies that they prefer. But it would be ridiculous for us to take this company and split it up into eight different companies. Because at the end of the day, the terminal value of this company will be the same as the terminal value of eight different single play companies that would let's say have identical assets to us.

So we actually think also that there is a lot of value to not being a single play company, certainly on a risk-adjusted basis. We can deliver returns to investors that are not dependent on one play. And sometimes plays don't work out. And we've been a single play company, we were that 10 years ago and we are never going to go back to that. So nine years ago this company's stock price was \$0.75. Today it's almost 50 times that.

So I'm not ever going to complain about our stock price performance. I'm thrilled with it. I've continued to invest and I believe I'm the Company's third-largest investor right now and I'm pleased to have been able to do that and I hope to be able to continue to do that going forward. At the same time, I think it would be irresponsible for me not to provide a roadmap for investors to see the value that we think is latent in a company that is a large, rapidly growing company that is diversified instead of its really

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a rollup, if you will, of as many as 10 different single play companies that arguably at this particular point in time might be more highly valued in the marketplace.

But I think at the end of the day, which is the only day that matters to me, we will be actually ahead of a collection of single play companies because we will be more efficient in our risk and our risk will be lower getting to that terminal date in the future.

Kurt Hiler - *Adage Capital - Analyst*

All right, thanks.

Operator

Mike Breard, Hodges Capital.

Mike Breard - *Hodges Capital - Analyst*

Yes, you've made a lot of progress in the Barnett Shale in terms of learning how to better frac and complete the wells. Could you give us some idea of what you would expect an average new well to come onstream at today versus a year or two ago?

Aubrey McClendon - *Chesapeake Energy - CEO*

I'm sorry, Mike, did you mention what the initial production would be?

Mike Breard - *Hodges Capital - Analyst*

Yes, because of better frac techniques and so forth.

Aubrey McClendon - *Chesapeake Energy - CEO*

Yes, our reserves today are 2.65 bcf on an estimate recovery for Core and Tier 1 acreage. And I believe a year ago we were at 2.45 on that number, maybe 2.5 and initial production rates would have been just about the same. What's happened over time is that we've noticed that our wells are declining less rapidly than we had thought and so our terminal decline rate is slightly different than it was a year ago.

Mike Breard - *Hodges Capital - Analyst*

Okay, so the advantage has resulted in a longer life well versus the higher initial production?

Aubrey McClendon - *Chesapeake Energy - CEO*

That is correct.

Mike Breard - *Hodges Capital - Analyst*

Thank you.

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Operator

Sunil Jaqwani, Catapult Partners.

Sunil Jaqwani - Catapult Partners - Analyst

Good morning. I jumped on the call a little late so I apologize if this has been asked. But I noticed that your Marcellus unrisks well count was only at 1,300 or 1,400 barrels over 1 million acres and I'm guessing that it is just because it is early but I did want to see if I could get a comment on that.

Aubrey McClendon - Chesapeake Energy - CEO

Sure, at this point we are risking our acreage by 75%. You might have missed earlier for example in the Fayetteville, it was 40% and results have indicated that we should move that down to 20%. So we are at 75% in the Marcellus and obviously the play over time as it develops that risk factor is likely to go down and you will see a pretty dramatic jump up in the amount of risked unproved reserves that we have.

Sunil Jaqwani - Catapult Partners - Analyst

And, Aubrey, just a follow-up to that. In your opinion, what is the difference in the rate of return for say a Huron horizontal well versus Marcellus again recognizing that it is really early?

Aubrey McClendon - Chesapeake Energy - CEO

I think it is too early to make that comparison and so we will just ask you to hang on with us and we and other fine companies that are out there drilling those kind of wells will be providing more information as we develop it in 2008 and beyond.

Sunil Jaqwani - Catapult Partners - Analyst

Thank you and congratulations.

Aubrey McClendon - Chesapeake Energy - CEO

Thank you much, I think that brings us to a conclusion and I appreciate everybody's interest today and we will do it again a week from now with an emphasis on the financial results of the company. Thank you.

Operator

Thank you. That does conclude today's conference. You may disconnect at this time.

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