

---

# **Henderson State University**

**Chesapeake Energy Corporation  
November 4, 2009**

# Appendix

---

**Investment Thesis  
Profile  
Stock Chart  
Business Synopsis  
Products/Services  
Internal Analysis  
Headlines  
Industry Analysis  
Competitors  
Valuation Tables  
Summation**

# Investment Thesis

---



**Chesapeake Energy Corporation**

**(CHK \$26.60)**

**One Year Target Price: \$33.19**

**Opinion: Equal Weight**

# CHK Profile

General Information	
Ticker	CHK
Exchange	NYSE
Sector	Basic Materials
Industry	Independent Oil and Gas
Headquarters	Oklahoma City, OK
Purchase Date	Na
Purchase Price/Shares	Na
Current Price	\$26.60
Book Value Per Share	\$18.32
52- Wk Low /High	\$9.84-30.00
52- Wk Change	24.23%
52- Wk Relative	-
Market Cap.	18.45 B
Shares Outstanding	641.65 M
Inst. Ownership	72.6%
Float	634.91 M
Average Volume (3m)	14,900,700
Short Interest	
Beta	1.39
EPS	3.55
PE Ratio (Average)	10.00
PEG Ratio	1.62
Dividend/Yield	.3, 1.00%
IPO	-

Estimates
SMF (rev, EPS, DCF)
• 1Q10E:
• 2010E:
• 2011E:
Consensus
• 1Q10E: .47
• 2010E: 2.40
• 2011E: 3.24
Guidance
• 2010E
– Rev:
– Adj. EBITDA:
– Option:
–

Coverage
• Buys
– Oppenheimer, B&S, Bernstein,
– JP Morgan, SMH, Capital
Southcoast, Jefferies, Wachovia,
• Holds
– Argus, Howard Weil, Citigroup,
– Fortis Bank, Prudential
• Sells
– Credit Suisse
–

Sources: yahoo.com, marketwatch.com, reuters.com, company documents

# Stock Chart

CHK (Chesapeake Energy Corp.) NYSE

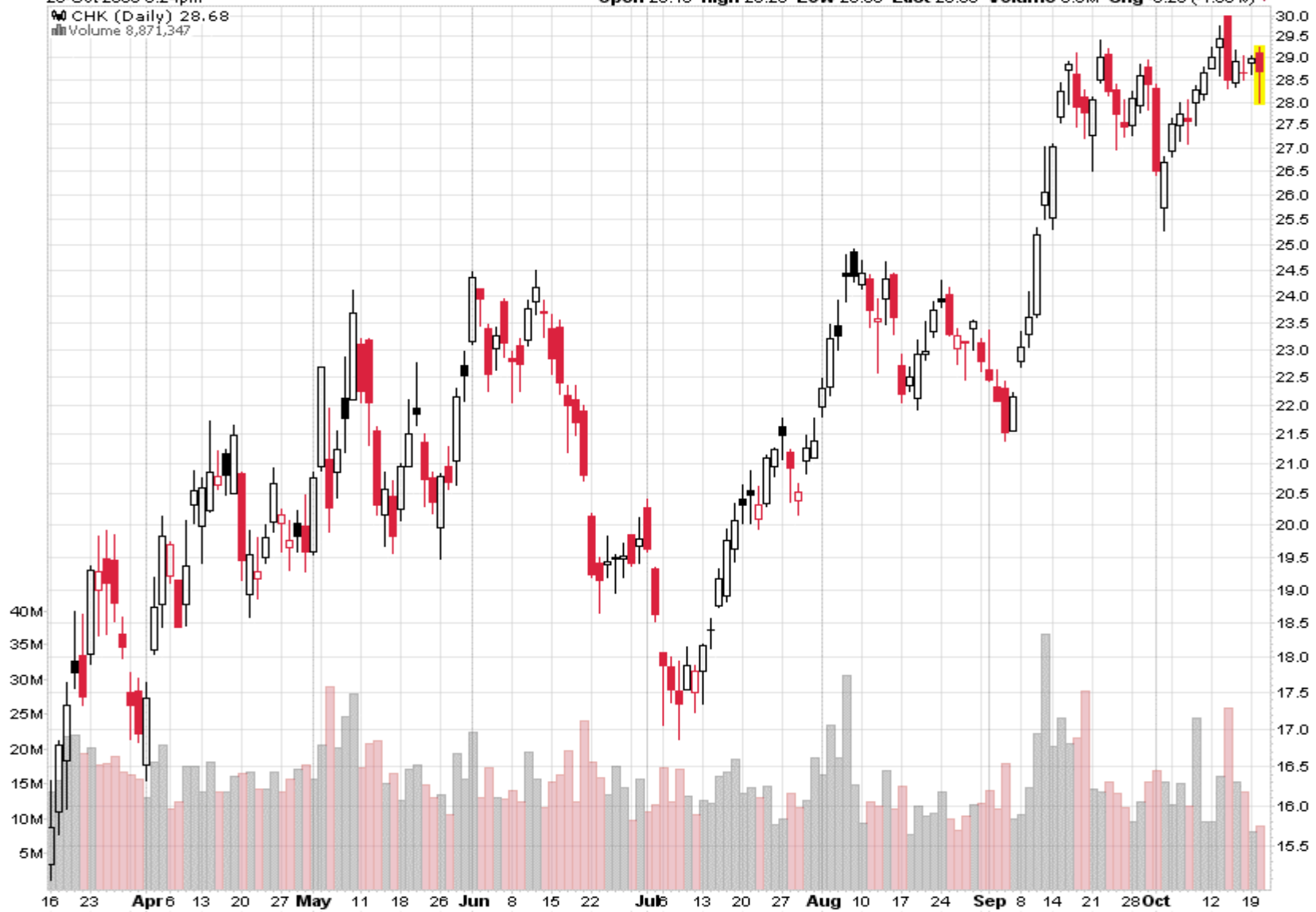
20-Oct-2009 3:24pm

CHK (Daily) 28.68

Volume 8,871,347

Open 29.13 High 29.25 Low 28.00 Last 28.68 Volume 8.9M Chg -0.29 (-1.00%)

© StockCharts.com



# Business Synopsis

---

## Description

Chesapeake Energy Corporation, an oil and natural gas exploration and production company, engages in the acquisition, exploration, and development of properties for the production of crude oil and natural gas from underground reservoirs. It also provides marketing and midstream services for natural gas and oil for other working interest owners in properties it operate. The company's properties are located in Oklahoma, Texas, Alabama, Arkansas, Louisiana, Kansas, Montana, Colorado, North Dakota, Nebraska, New Mexico, West Virginia, Kentucky, Ohio, New York, Maryland, Michigan, Mississippi, Pennsylvania, Tennessee, Utah, Virginia, and Wyoming. As of December 31, 2008, it owned interests in approximately 41,200 producing natural gas and oil wells; and had 12.051 trillion cubic feet equivalent of proved reserves. The company was founded in 1989 and is based in Oklahoma City, Oklahoma.

# Products/Services

---

Natural Gas – Accounts for 92% of Chesapeake’s drilling. Chesapeake is the largest producer of new wells in the United States and one of the overall top producers of Natural Gas. Most of Chesapeake’s drilling takes place in four main “plays.” They are Barnett Shale of North-central Texas, Haynesville shale of East Texas and Northwest Louisiana, Fayetteville shale of Central Arkansas, and the Marcellus shale of the Northern Appalachian Basin.

Oil – Accounts for remaining 8% of drilling.

[Type text]

# Internal Analysis

---

**Valueline.com Safety Ranking: 3**

**Management:**

Aubrey K. McClendon – Chairman of the Board and Chief Executive Officer

Marcus C. Rowland – Executive Vice President and Chief Financial Officer

Steven C. Dixon – Executive Vice President – Operations and Chief Operating Officer

**Channel Checking:**

Greatest investment in new drilling.

Most new drilling rigs this year.

**SWOT Analysis:**

Strengths- Large barriers to entry. Already one of the largest Natural Gas drillers in the United States and the World, which puts them in a position of dominance in the industry. Largest producer of new wells in the United States.

Weaknesses- Natural Gas Prices are hit all time lows this year and remain well below average levels. To this point, oil is still the primary energy source. Supply is way up and demand is down for Natural Gas this year. Until Natural Gas is taken more seriously as a source of energy, especially for vehicles, Natural Gas may remain at a low cost.

Opportunities- Since Chesapeake is the largest producer of new wells in the United States they have a great chance at sustained growth. Natural Gas prices are an opportunity as well as a threat. If prices rise, Chesapeake benefits, if they fall, Chesapeake will be hurt.

Threats- Weather. Natural Gas Prices. Over supply resulting in no room for more gas. Competition from other major producers such as BP.

# Headlines

---

- recent news that had a positive or negative effect on the stock and its subsidiaries
- recent earnings call transcript from [www.seekingalpha.com](http://www.seekingalpha.com)

Chesapeake shows its muscle.

[http://us.rd.yahoo.com/finance/external/forbes/SIG=12pvn6ulj/\\*http%3A//www.forbes.com/2009/10/15/chesapeake-natural-gas-business-energy-drilling.html?partner=yahootix](http://us.rd.yahoo.com/finance/external/forbes/SIG=12pvn6ulj/*http%3A//www.forbes.com/2009/10/15/chesapeake-natural-gas-business-energy-drilling.html?partner=yahootix)

Gas storage at new all time high

<http://biz.yahoo.com/zacks/091019/26082.html?v=1>

Chesapeake's new production outlook

<http://biz.yahoo.com/zacks/091020/26170.html?v=1>

## August 4<sup>th</sup> Quarter 2 call transcript

### **Aubrey McClendon**

Thank you, Jeff and good morning. We're hopeful that you found it easier to process all of Chesapeake's operational and financial information this quarter through the two press releases rather than our customary one press release.

We're also hopeful that you noticed that the results of our asset quality and the benefit of our carries that Chesapeake's drill bit finding costs in the second quarter were only \$0.87 per Mcfe. Certainly that will be the lowest in the industry reported this quarter.

Furthermore, we hope you noticed that returns from drilling in our two granite wash plays are above 100% even in today's low gas price environment. Moreover, we hope you noticed the financial power of our joint venture carries, which paid \$311 million dollars in Chesapeake's drilling costs during the quarter. I don't really believe investors have fully focused on what these carries do for our returns on investment.

In the Haynesville, for example, our 50% carry from PXP decreased our drill-bit finding cost during the quarter to the incredible level of only \$0.47 per Mcfe, while boosting our rate of return to 345% from 42% pre-carry. That is more than a 700% better return than the rest of the industry will likely be able to achieve in the Haynesville.

Remember this carry doesn't include what we have already collected upfront on the initial acreage sale. For example, the per acre cost for Chesapeake's industry leading 510,000 net acres in the Haynesville, is now just \$6,000 per net acre, which compares very favorably to a recent valuation of such acreage in the EXCO-BG joint venture at almost \$20,000 per net acre.

In the Marcellus, it is even better as our 75% carry from Statoil reduced our drill bit finding cost during the quarter to the also incredible level of only \$0.43 per Mcfe, while boosting our rate of return to more than 1,000% from 71% pre-carry. That is more a 15 times better return than our competitors will likely be able to achieve in the Marcellus.

Remember, this carry also doesn't include what we collected upfront on the initial acreage sale to Statoil. The acreage cost for Chesapeake's industry leading 1.4 million net acres in the Marcellus is now just \$80 per net acre, which compares of course, very favorably to recent off the ground leasing at more than 30 times its cost.

Finally in the Fayetteville we actually have a negative cost of more than \$8,000 per net acre. And our returns during the past year into the end of 2009 will be infinite because BP is paying for 100% of Chesapeake's drilling costs in the Fayetteville.

Infinite returns are of course pretty tough to obtain and to beat but we have done it in the Fayetteville for all of 2009. It's really very simple. The combination of our JVs and our huge core acreage positions in America's greatest gas plays should enable Chesapeake to lead the industry in value creation for years to come.

Some of you may question our financial discipline. Can Chesapeake live within its cash resources? Well, of course we can, and we are, and we have.

Through our operating cash flow, augmented by our asset monetization's we expect to deliver 4% to 5% production growth in 2009, and 7% to 8% production growth in 2010, plus, increase Chesapeake's proved reserve, during '09 and '10, from 12 Tcfe to 16 Tcfe all the while generating excess cash of \$1.1 billion to \$2.1 billion in '09 and '10.

By generating this excess cash and by increasing proved reserves by 33%, we will substantially deleverage Chesapeake's balance sheet and have investment grade credit metrics by year end 2010. Chesapeake's second quarter results should be just the beginning of a very long string of quarterly results that will showcase the power of our assets and the strength of our financial returns.

In our view it will be an unbeatable combination and will create very substantial amounts of shareholder value for years to come. I now turn the call over to Marc Rowland for his comments, Marc?

## **Marc Rowland**

Good morning, everyone. Like Aubrey's comments mine will be brief this morning as well. One very positive trend over the last few months has been a dramatic improvement in narrowing basis. Therefore an improvement in well-head realizations compared to Henry Hub.

For example, August basis for mid-continent has measured at Panhandle Eastern is only a minus \$0.26. We have not seen basis this narrow since 2004. Likewise, WAHA another delivery point is minus \$0.8, not seen since 2003. Houston Ship Channel is actually a positive \$0.03 compared to the Hub. We continue to receive positive basis in the east of around \$0.20. We think this trend can continue, as gas volumes drop and once again there is more takeaway pipe capacity than production in many of our operating areas.

On the asset monetization side of our business, the market continues to improve with many more investors now interested and at improving discount rates. To put the sales in some perspective, BBP's numbers five and six have about 123 Bcf of total volume, associated with them. And will sell for about \$5 per Mcf on a weighted average between them. Yet in just three months, we added 836 Bcfe at a cost of just \$0.87. We think that's a pretty good program.

Finally, one note on cost trends. As you can see from our release, just about all of our production and other cash cost are down or at worst to flat from quarter-to-quarter. We continue to see some downward trend in drilling and completion costs as well, although not at the rate of decrease we saw in the fall and first half of 2009. We expect this trend to remain a positive development for the balance of this year, at least.



# Industry Analysis

How has this industry done compared to the market? Diagnostic Substances

## Industry Statistics

Market Capitalization:

394.7M

Price / Earnings:

10.00

Momentum Indicator: 2 of 10

Sector Rotation: 67 of 98



# Competitors

- 
- 

Competitor companies with substitute products

Companies that have some of the same numbers

## DIRECT COMPETITOR COMPARISON

	CHK	APC	BP	COP	<a href="#">Industry</a>
Market Cap:	18.51B	32.52B	175.36B	78.45B	394.70M
Employees:	7600	4300	92000	30000	81
Qtrly Rev Growth (yoy):	N/A	-28.60%	-49.60%	-52.30%	14.00%
Revenue (ttm):	14.14B	12.48B	266.72B	166.89B	125.42M
Gross Margin (ttm):	72.21%	80.66%	15.75%	27.33%	68.47%
EBITDA (ttm):	9.85B	6.76B	28.92B	25.48B	77.27M
Oper Margins (ttm):	-31.86%	25.59%	5.82%	9.72%	1.34%
Net Income (ttm):	-3.10B	2.39B	11.65B	-24.44B	N/A
EPS (ttm):	-5.32	5.112	3.70	-16.377	N/A
P/E (ttm):	N/A	12.97	15.18	N/A	13.19
PEG (5 yr expected):	1.62	N/A	2.26	N/A	2.9
P/S (ttm):	1.31	2.65	.66	.47	3.02

Great Potential in an industry that may produce great growth if gas comes in favor or negative growth if gas goes the way of ethanol. I would suggest we keep this company on the watch list, or consider replacing it with Anadarko. I would not consider buying CHK or APC at this time.

If we own:

Sell

If we don't:

Don't buy

Chk Is overvalued at this time.

# Valuation Tables

- DCF model
- Over Valued/ Under Valued
- 

Stress Test (PE and EPS sensitivity)

## P/E Sensitivity

Present Value	Price 2006	P/E 2006	EPS 2006	HPR 2006	Annual Return
7.99	16.96	4.0	4.24	0.73	-5.19%
11.99	25.44	6.0	4.24	1.05	0.86%
15.98	33.92	8.0	4.24	1.37	5.54%
<b>19.98</b>	<b>42.40</b>	<b>10.0</b>	<b>4.24</b>	<b>1.69</b>	<b>9.39%</b>
23.97	50.88	12.0	4.24	2.00	12.68%
27.97	59.36	14.0	4.24	2.32	15.57%
31.96	67.84	16.0	4.24	2.64	18.14%

## Earnings Sensitivity

Present Value	Price 2006	P/E 2006	EPS 2006	HPR 2006	Annual Return
17.15	36.40	10.0	3.64	1.46	6.73%
18.09	38.40	10.0	3.84	1.54	7.65%
19.03	40.40	10.0	4.04	1.61	8.54%
<b>19.98</b>	<b>42.40</b>	<b>10.0</b>	<b>4.24</b>	<b>1.69</b>	<b>9.39%</b>
20.92	44.40	10.0	4.44	1.76	10.21%
21.86	46.40	10.0	4.64	1.84	11.00%
22.80	48.40	10.0	4.84	1.91	11.77%

Required Rate - 13.81%



---

HISU