

FINAL TRANSCRIPT

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CHK - Q2 2011 Chesapeake Energy Corp Earnings Conference Call

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PRESENTATION

Operator

Good day, everyone, and welcome to the Chesapeake Energy 2011 second quarter earnings results conference call. Today's call 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 Corporation - SVP of IR and Research*

Good morning and thank you for joining our 2011 second quarter earnings and operational results conference call. With me this morning are Aubrey McClendon, our Chief Executive Officer; Steve Dixon, our Chief Operating Officer; Nick Dell'Osso, our Chief Financial Officer; and John Kilgallon, our Director of Investor Relations and Research.

Our prepared remarks by Aubrey and Nick should last about 20 minutes and then we'll launch into Q&A. Aubrey?

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Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

Good morning. We hope you've had time to review yesterday's 2011 second-quarter operational and financial release. The quarter was very successful on a number of fronts and they have set the stage for further successes in the second half of 2011 and throughout 2012.

Because the quarter progressed quite smoothly operationally and financially, I will focus my comments on providing an update on four of our best liquids plays about which you haven't heard much from us until now. These four would be the Mississippi Lime play in Northern Oklahoma and Southern Kansas, the Cleveland and Tonkawa tight sands plays in the Anadarko Basin of Western Oklahoma and last but certainly not least, the Utica Shale play in Eastern Ohio.

First, with regard to the Mississippi Lime horizontal play, Chesapeake discovered this play in April 2007 with the drilling of the Howell 1-33H well in Woods County, Oklahoma. This was the first modern horizontal Mississippi Lime well drilled in Oklahoma.

The well cost was approximately \$2.7 million and we found approximately 285,000 BOE in this well. A very, very successful first effort. However, 2007 was also the year in which we discovered the Colony Granite Wash play in Western Oklahoma, a play that has now us seen drill 126 wells and develop 225 million gross barrels of BOE reserves from those 126 wells.

Because we were unsure of the ultimate size of the Mississippi Lime play and unsure of how predictable the rocks would be, we ended up developing our Granite Wash assets more quickly. However, in the past year, it has become more clear that we have a major play on our hands in the Mississippi Lime and so we ramped up our leasing and drilling efforts quite significantly.

Today we own 1.1 million net acres in the Mississippi Lime, the most in the industry, and we are presently using six rigs to develop leasehold. We anticipate increasing our rig count to 10 by year-end 2011 and anticipate reaching a drilling activity level of 30 to 40 rigs by year-end 2014 or perhaps 2015.

To date we have drilled 56 Mississippi Lime horizontal wells and have found an average of 415,000 barrels of oil equivalent per well at an average finding cost to date of approximately \$11 per barrel. Obviously very, very attractive results to date.

We are planning to develop Chesapeake's 1.1 million net acres on 160 acre spacing and therefore believe we can drill up to 6,750 net wells on our leasehold in the years to come. This could create approximately 2.2 billion barrels of unrisks oil equivalent impact to Chesapeake.

We anticipate pursuing a JV or other monetization event in this play in the first half of 2012. We are extremely proud of our northern Mid-Continent asset team for discovering this very significant play four years ago.

It will be an important contributor to the upward march of our liquids production in the years ahead. Next I would like to talk about our Cleveland and Tonkawa plays, which are also located in the Anadarko basin of western Oklahoma.

Although they are separate and distinct tight sand formation, our results from the Cleveland and Tonkawa plays to date have been close enough to each other that we use one combined pro forma EUR for these two plays. One reason you've not heard too much about these plays is that Chesapeake's 720,000 net acre leasehold position across these plays is so dominant that no other public E&P company has been able to build a meaningful competing interest and talk up the play.

Part of this leasehold dominance is a direct result of Chesapeake's history in the Anadarko Basin. From 2001 through 2007, Chesapeake built the industry's leading acreage position in the basin.

Lease by lease and acquisition by acquisition, as we executed our 'let's get long' natural gas business strategy. During this time we were drilling wells to develop conventional formations from 12,000 to 25,000 feet deep.

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Perhaps you noticed last week our press release describing the success of one such deep conventional well, the Buffalo Creek 1-17, a Chesapeake Deep Springer well that has now produced more than 60 billion cubic feet of natural gas and is one of the six most productive gas wells ever drilled in Oklahoma.

It has now paid out its capital investment more than 37 times since we drilled it. Incidentally, Chesapeake now operates four of the six largest gas wells ever drilled in Oklahoma.

Because of this unmatched leasehold position in the Anadarko Basin, Chesapeake possesses unique informational and operational advantages which have enabled us to discover several large new plays in the region. The Anadarko Basin is today one of the two premier liquids-focused basins in the US with the Permian Basin being the other.

Chesapeake now owns more than 2 million net acres of leasehold in the Anadarko, of which we believe about 720,000 should be prospective for the Cleveland and Tonkawa. To date we have drilled 116 horizontal Cleveland and Tonkawa wells and our gross estimated pro forma reserves are approximately 600,000 BOE per well, providing finding and development costs of about \$12 per barrel.

These economics are providing us with exceptional returns from our Cleveland and Tonkawa investments. We now have 16 rigs drilling in these plays and anticipate increasing this rig count to around 25 or 30 in the next few years.

We expect to develop these two plays on 160 acre spacing, the same as we used to develop the Granite Wash to the south and therefore believe we could drill up to 4400 net Cleveland and Tonkawa wells on our leasehold and therefore develop about 2.0 billion barrels of unrisks oil equivalent net to Chesapeake.

We are very proud of our Anadarko Basin asset team for discovering the Tonkawa horizontal play in 2008 and also being very early to understand the significance of the Cleveland as well. These two plays will remain primary drivers of Chesapeake's surging lease liquids production in the years ahead.

With regard to the Utica Shale, we are happy to report confirmation of market rumors that Chesapeake has made a major new liquids-rich discovery in the Utica Shale of Eastern Ohio. In some respects, the play reminds us of the Haynesville Shale in the fact that we worked undercover for more than a year to develop the basic geological and petrophysical model.

We built the largest leasehold position in the play and then drilled the first discovery wells. This is certainly also the case with the Utica where we started working on the play 1.5 years ago, started buying leases shortly thereafter and today quietly and efficiently have built the largest leasehold position in the play.

Importantly we are the only company that has drilled a producing horizontal Utica Shale well in Ohio. On the other hand, economically the Utica looks similar but is likely superior to the Eagle Ford Shale in South Texas.

The similarity is that we expect the Utica to have three phases -- a dry gas phase on the eastern side of the play, a wet gas phase in the middle and an oil phase on the western side. The difference is that we believe the Utica will be economically superior to the Eagle Ford because of the quality of the rock and the location of the asset.

While we are not ready yet for competitive reasons to discuss our production results to date or our reserve estimates for the future, I can confirm that we have drilled nine vertical wells, have drilled six horizontal wells, have drilled and analyzed 3200 feet of proprietary Utica core and have examined over 2000 well logs that have penetrated the Utica to date. As with every other shale play, the highest returns go to the companies that have focused their leasehold buying in the core of the play as Chesapeake has done in the past in the Barnett, Haynesville and Marcellus and as we are doing again in the Utica.



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So what's the Utica going to be worth to our shareholders? Based on what we have seen from our first wells and what we have seen from recent Eagle Ford JVs and other JVs across the industry, we believe our 1.25 million net acres in the Utica should be worth \$15 billion to \$20 billion to Chesapeake shareholders.

That's a big number to be sure, but we believe we understand the hydrocarbon potential under our acreage and we also know a fair amount about how to create and extract value from a play such as this. I might also add that in the Utica as in the Mississippi Lime, we have been approached with a number of alternative monetization ideas that we believe will be quite competitive with the standard industry JV process.

We are very excited about this new Utica discovery and believe over time it will be more important to us and the industry than the four other major unconventional plays that Chesapeake has discovered over the past four years -- the Granite Wash, the Haynesville Shale, the Tonkawa Sand and the Mississippi Lime.

We're also very excited about Utica's very positive implications for the State of Ohio and in fact for the entire US, as the Utica should emerge as a key driver in the future growth of the US energy supplies, especially in natural gas liquids. I would like to complement the efforts of Chesapeake's Appalachian Basin asset team for their discovery of this play and for assembling the remarkable and dominant leasehold position we have acquired in the past year.

I would also like to express my appreciation to Governor John Kasich who was elected Ohio's Governor in November of last year. Governor Kasich like Governor Corbett in Pennsylvania is a no-nonsense pro-business leader and he has already built a strong team that is supportive of our industry and also supportive of a stable and business-friendly legislative and regulatory environment. In addition to supporting industries that supply energy, Governor Kasich's administration has consistently demonstrated encouragement for the capital investment, job creation and collaboration with industrial energy consumers that can also help expand demand for natural gas.

Finally, there is a significantly under-utilized workforce in Eastern Ohio and through our drilling efforts, leasing efforts, midstream pipeline and processing efforts plus our plan to help build out the nation's badly needed CNG and LNG transportation infrastructure, we expect to assist in a major economic rejuvenation of Ohio. I might also add that the only public company with an acreage position of any real size in the core of the Utica play is EnerVest in Houston.

EnerVest is a highly regarded MLP whose CEO is John Walker, a very good friend of Chesapeake's over the years. We're 50-50 partners with EnerVest on some of their Utica acreage and on other of their acreage they retain 100%.

We expect to continue working closely with them as we develop the play in the years ahead. Reflecting the size of our leasehold position and the drilling results we have seen to date, we are beginning a very serious ramp up of Utica drilling activity. We started with one rig seven months ago, are now up to five rigs and expect to be at eight rigs by the end of this year and ultimately we are likely to reach around 40 rigs drilling in the Utica by year-end 2014.

One final element of my remarks is that sometimes we're asked to comment on our overall gross operated production for our major plays, so I thought I would give you a rundown this morning as follows. I'll start with the Haynesville.

It was discovered by Chesapeake in 2007. Current gross operated production is 1.7 BCF per day. That's been built 100% organically in just four years. If Chesapeake's Haynesville asset were a stand-alone company, it would remarkably be the seventh largest gas producer in the US by itself.

Barnett, first Chesapeake production was in 2004. Current gross operated production is 1.25 BCF per day. We remain the second largest producer in the play behind Devon.

Marcellus, first Chesapeake production was 2008. Current gross operated production is 730 million cubic feet of gas equivalent per day. We are the top producer in the play.



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Granite Wash, discovered by Chesapeake in 2007. Current gross operated production is 420 million cubic feet of gas per day, the most by far in the play.

Permian Basin horizontal plays, first Chesapeake production was 2007. Our current gross operated production is 100 million per day equivalent.

Eagle Ford Shale, first Chesapeake production was in 2010. Our current gross operated production is 20,000 barrels of oil equivalent, making us the fourth-largest producer in the play to date.

Cleveland and Tonkawa, the Tonkawa was discovered by Chesapeake in 2008. Current gross operated production is 25,000 BOE per day, making Chesapeake the largest producer in these two plays as well.

So that's a total of 4.5 BCF per day of gross operated production from plays that basically didn't exist four years ago. I hope you'll agree that's a pretty remarkable achievement and a distinctive one as well.

I also hope that you can see from these gross operated production amounts just how quickly we can ramp up production from new plays. I expect we will do quite well in accomplishing the same ramp-up in the years ahead from other new plays, most notably the Mississippi Lime, Cleveland and Tonkawa and Utica.

You might also note from our press release yesterday that if we had not sold our Fayetteville Shale assets and VP9 assets earlier in the year, Chesapeake's year-over-year production growth would have been 700 million cubic feet of gas equivalent today which coincidentally happens to be roughly equivalent to the average daily production of Petrohawk, Newfield or Pioneer; three very fine companies with enterprise values averaging about \$15 billion per company.

Another way to think about this achievement of 700 million a day year-over-year production growth is to consider that in this past year, we have developed organically the same amount of production that Concho and SandRidge have on a combined basis. These are two other very fine companies with a combined enterprise value of approximately \$20 billion.

This is further evidence of the extraordinary value creation machine that we have built for the benefit of Chesapeake's investors. And as important as the really incredible growth that we have achieved, we are also quickly migrating to liquids-focused plays which will sharply increase our profit margins and returns on capital in the years ahead.

In closing, I would like to alert you that our much discussed ramp down of drilling activity in the Haynesville and Bossier plays is well underway. From our high watermark a few months ago of 36 rigs which were needed to HBP our acreage, today we are down to 33 rigs; and of those rigs, nine are drilling their last wells, meaning they should be released in the next 30 days or so.

We expect to be down to just 15 Haynesville and Bossier rigs by year-end 2011 and expect to hold that activity constant until natural gas prices improve in the years ahead. This should be bullish for natural gas in the years ahead. I'll now turn the call over to Nick.

Nick Dell'Osso - Chesapeake Energy Corporation - EVP and CFO

Thanks, Aubrey. The second quarter was truly a very successful quarter for Chesapeake where we continued on our 25/25 plan by achieving a high organic production growth rate and completing our \$2 billion bond tender.

As Aubrey discussed on the production front, we are very excited about our rapidly growing oil and natural gas liquids production. Liquids production was up 19% quarter over quarter and 62% year over year.



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This quarter, 16% of our total production came from oil and natural gas liquids which equated to 28% of our revenue. We are very quickly becoming leveraged to oil.

In addition, our natural gas production continues to grow causing us to increase our two-year estimated production growth rate to 30%. Therefore as of today, our 25/25 plan officially becomes the 30/25 plan.

And it's my hope that before year end 2012, the plan may be amended once again to accommodate further debt reduction in that it becomes known as the 30/30 plan. Net income for the quarter came in at \$528 million or \$0.76 per fully diluted share beating consensus estimates by 4%.

Operating cash flow was a very strong \$1.4 billion. As you review our detailed release, you may note an increase in our LOE per MCFE. This was driven by removal of our Fayetteville assets from the portfolio, a very low operating cost region.

On the reserve front, we announced yesterday evening that we added 2.7 TCFE of proved reserves in the first half of the year. Coincidentally, that's approximately the same amount of proved reserves we sold in our Fayetteville Shale transaction for \$4.65 billion, giving another data point to support the value creation machine we have here at Chesapeake.

Additionally from a value perspective, the Fayetteville reserves were 100% gas. The reserves we replaced them with through the drillbit were 31% liquids and cost us only \$1.29 per MCFE to find and develop.

As a reminder, the PV-10 of our proved reserves at the 10-year and NYMEX strip on June 30 is \$27.4 billion or 70% of our \$39 billion enterprise value. Of course, in addition to our proved reserves, we hold \$4 billion of midstream assets, \$7 billion of oilfield service assets, \$3.5 billion drilling carry and over \$2.7 billion of other assets and investments which totals about \$44.5 billion.

We look forward to continuing to execute on our plans and closing the net asset value gap for you all where, based on the items that I just ticked off, investors are getting our 13.2 million undeveloped acres which we estimate hold about 18 billion barrels equivalent of risked unproved resources for less than zero; pretty remarkable opportunity for value.

As part of our revised outlook yesterday evening, we've also adjusted our production and CapEx guidance for the remainder of 2011. The increase in our production is a result of the great success we continue to have with the drillbit and highly prolific nature of our plays.

In particular, the Haynesville and Marcellus, for which we increased the estimated ultimate recovery for the Marcellus to 5.75 from 5.25 BCF per well. On the CapEx front, we are ramping up our Utica drilling based on the very encouraging results that we have seen to date and that Aubrey elaborated on previously.

However, oilfield service inflation cannot be ignored as the primary culprit in our increased CapEx guidance. Unique from others in the industry, we are hedged against this inflation and have benefited greatly from our strategy to be vertically integrated into the drilling, rental tool, trucking and now pressure pumping businesses.

Based on a recent internal analysis we completed on the Eagle Ford, we estimate that when we drill a well with our own service company assets, our drilling and completion costs are 17% lower than when drilled with third-party providers. Also, we have invested approximately \$1.2 billion in our oilfield services assets to date, inclusive of our Frac Tech stake and believe they are worth approximately \$7 billion today.

Lastly, I would like to highlight updates to our hedge book. We're 79% hedged on gas production for the second half of 2011 and approximately 33% hedged for the first half of 2012. We do believe that there is likely more upside than downside risk to the gas curve over the next 12 to 24 months which is reflected in our current hedge position. We remain relatively unhedged on oil.



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With that, operator, please open up the line for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) David Heikkinen, Tudor, Pickering, Holt.

David Heikkinen - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Aubrey, as you think about the \$15 billion to \$20 billion evaluation, is that before a monetization or after?

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

It's basically just what we think the acreage is worth in a monetization. And so, you just...

David Heikkinen - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Eight eighths?

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

Yes, eight eighths exactly. Over time of course as we convert the leasehold into producing assets, it will be worth a lot more than that. I'm just saying today based on what we've seen in JVs and what we think we've got here, it's not unreasonable to think about an eight eighths valuation of the asset at that level.

David Heikkinen - *Tudor, Pickering, Holt & Co. Securities - Analyst*

And would you classify the wells you've drilled so far as oil wells?

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

Dave, we're not going to release anything further about the play than what we've said. But in time, we certainly will.

David Heikkinen - *Tudor, Pickering, Holt & Co. Securities - Analyst*

And the splits of what three regions you've actually leased in either?

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

No, but I mean you know -- you are a research analyst and other people are as well. I mean there's public records out there and wells are hard to hide. So there's plenty of information out there if people want to go find out about it.

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David Heikkinen - *Tudor, Pickering, Holt & Co. Securities - Analyst*

And then seeing large companies now start splitting up to unlock value and you all have talked a lot about the sum of parts value, how do you think about the benefits of being a larger company as you kind of aggregated the assets?

You've been splitting up and selling parts. How do you keep the whole thing together or do you think about a bigger benefit of splitting up to unlock value?

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

I think about covering first of all, we've spent between \$1.5 billion and \$2 billion acquiring leasehold in the Utica. If we were a smaller company, we wouldn't have been able to take on net risk.

We've put together one of the nation's largest collections of oilfield service assets which are going to give us -- have given us a hedge against the rising service costs that nobody else has. You know, the frustration here is that yesterday we had to increase our drilling CapEx by 500 million in 2011 and 2012.

But we also couldn't say hey, we think we made more than that in just the increase in value of our service assets during that same time. So to me, the integrated approach makes sense.

Our size and scale enables us to discover things that we wouldn't otherwise be able to do. So, Nick may have some comments on it or some thoughts on that as well.

Nick Dell'Osso - *Chesapeake Energy Corporation - EVP and CFO*

David, you commented on the breakups that you see in the industry and that's really counter to the strategy that we've outlined here and that we are trying to pursue. We would like to pursue partial monetizations of these businesses, not dissimilar to what we achieved with our midstream business so that we can point to the value that we have created in these businesses and also capitalize them separately.

We believe there are different costs of capital for each one of these businesses and it's sufficient and frankly a little clearer for the Wall Street community if we do it separately. So, we like that model.

We think it gives us an opportunity to recognize value from what we've created. But, vertical integration is core to our strategy and we don't want to give up the control and ability to affect how we use those assets in the field every day.

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

And would you think differently about our 2011-2012 CapEx budgets if we are able to show that our service assets are worth \$7 billion rather than \$1 billion or \$1.5 billion as our cost basis? That's our plan to be able to do that and I think we will be able to do that and think investors will benefit from investing in a company that is uniquely able to offset almost all, if not more than the service company inflation that it's facing in the operating environment today.

David Heikkinen - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Okay and then that actually segues into the final question I had. If I just back of the envelope looked at a 30 to 40 rig program, 25 rig program in the three plays or four plays you just outlined, you get multiples of your drilling budget just in those plays potentially? Can you talk about how you overall fund a 2014 plan and what your total budget would be or the implied budget is from what you just outlined?

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Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

Sure, David, we budget out through five years; so, out through 2016. And I also saw your note this morning.

Remember that the CapEx that we talk about here is a net CapEx. So, there's \$2 billion this year of carries in that and about \$2 billion next year as well.

And as we move forward in developing these plays, we'll have a carry in the Utica, we'll have a carry in the Mississippi Lime as well. So when you talk about a 2014 plan being \$3 billion net to the Utica at 40 rigs, that's true, but we don't expect to be paying 100% of that.

David Heikkinen - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Yes, I was just trying to get to the eight eighths value as well.

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

I understand what you did and I thought you did a great job on doing that, maybe a couple billion dollars light on the low side. But, still thought it was a great piece of work.

But, we are aware of the capital allocations and that's why we entered into these JVs to help us shoulder the load. With regard to where we end up, I think you've been with us on the road and you know that we are targeting about \$10.5 billion to \$11 billion of EBITDA in 2015 and cash flow would be right underneath that of course.

And so, with those resources which come from both expanding production but also from a much more profitable mix of production, as our production becomes more liquids focused, we believe we'll have plenty of capital to do everything that we need to do. And, reiterate, that's with keeping our debt where we target it to be which is right around \$10 billion at the end of 2012 and, also of course not to be selling any stock during that time as well.

Operator

Brian Singer, Goldman Sachs.

Brian Singer - *Goldman Sachs - Analyst*

Can you add a bit more color on the reasons beyond the geography of the stronger gas production? How much of that was related to well performance versus using longer laterals, reducing drilling days, reducing backlog? Just give us some sense as to the reason in both the Haynesville, the Marcellus and it seems like in some of the other plays as well for the strength in gas production.

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

Well I think it's related to kind of the opposite of what you read in the New York Times these days perhaps which is that as you drill more wells in these plays, they get better not worse. And so, Steve, if I think about our first Marcellus estimate, I think we were around 3 BCF on that well.

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We've steadily stepped it up as have others and so the evidence just became overwhelming to us and our core part of the play in Northeastern PA and Southwestern PA that we are finding at least 5.75 BCFE. So production has been overrunning our estimates which were predicated on lower EURs.

Haynesville we started out with 6.5 BCFE and I think that's where we still are. Production rates though over time have certainly tended to increase as we learn more about the play and I think sometimes people forget these 200-foot thick shale formations, there's a lot to be learned about them once you establish initial production.

Where is the right 20 feet? Where's the right 30 feet to drill?

And we are starting to discover that in all of our plays and so we're able to more optimally place well bores going forward. Think about the Barnett, Steve, I think we started at 1.6 BCF and today we're up to 3.3 BCF per well.

Aubrey McClendon - Chesapeake Energy Corporation - Chairman of the Board and CEO

So at any rate, this is what's so different about what we do today. In the old days your first well in a play was your best play and every well thereafter seemed to get worse.

Today we drill our worst wells first and that's one of the reasons that we are so optimistic about the Utica. We have not drilled our best wells here right out of the chute, we probably drilled our worst wells. So that gives us a lot of optimism about what we're likely to see down the road. So, specifically unless Steve wants to say something else, the outperformance is generally across the board. But, our strongest gas wells are in the Marcellus and the Haynesville.

Brian Singer - Goldman Sachs - Analyst

And in the Marcellus specifically with the EUR increase, that is completely well performance or have you also increased your lateral lengths?

Steve Dixon - Chesapeake Energy Corporation - EVP of Operations and Geosciences, and COO

Yes, I think it's all well performance.

Aubrey McClendon - Chesapeake Energy Corporation - Chairman of the Board and CEO

Our lateral length Steve on average in the Marcellus is around what?

Steve Dixon - Chesapeake Energy Corporation - EVP of Operations and Geosciences, and COO

Oh, 5,000.

Aubrey McClendon - Chesapeake Energy Corporation - Chairman of the Board and CEO

And then in the Haynesville, we remain constrained by the boundaries of the 640 acre spacing unit. So those laterals are about 4,500 feet.

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Brian Singer - *Goldman Sachs - Analyst*

Thanks. Then switching to the Utica, I guess looking at where the state has indicated you've permitted horizontal wells relative to your map of the play, it would appear your permanent horizontals are focused more on the wet gas window or on the border between the wet gas window and the oil window. Could you add a bit more color on location selection and where you see the best rates of return?

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

Yes, I think when you look at the Eagle Ford, you see the best rates of return in the wet gas window; it's got a lot of energy and got a lot of hydrocarbons stuck back into place. And so we think you can learn something about our approach to the play by seeing where our laterals are and going to the courthouse and seeing where our leases are.

So we like gas, we've got a lot of gas and so we're not focused as much on the dry gas window which also by the way I might add is much deeper. We've noticed some companies buying in areas where they are going to be drilling wells to 12,000 and 13,000 feet TBD with 5000-foot laterals. You're talking 17,000, 18,000 feet.

These are going to be at least \$10 million wells and maybe \$12 million to \$15 million wells and that's just simply not as attractive to us as drilling wells. TBDs of 7,000 to 9,000 feet stay in the wet gas window. We're going to have much more highly valued outputs and much lower cost inputs as well.

Brian Singer - *Goldman Sachs - Analyst*

Got it. And I guess comparing the wet gas window with the oil window, are there any issues as you start to move west regarding pressure or gas drive that do make that wet gas window superior to the oil window?

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

We won't be talking about issues other than the same issues that you see in every play. There are boundaries to every play and we have an opinion on those and other companies apparently have different opinions about those.

But we'll just see how it all plays out. But right now, we are interested in pursuing all three phases of the play but we have tried to focus our acreage right in what we think is the heart of the play, the core of the play and specifically the wet gas side of it.

Operator

Jeff Robertson, Barclays Capital.

Jeff Robertson - *Barclays Capital - Analyst*

Thanks, Aubrey, can you talk about any midstream needs in the Utica and the value for Chesapeake Midstream in participating in some of that development?

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

I'll let Nick talk about that.

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Nick Dell'Osso - *Chesapeake Energy Corporation - EVP and CFO*

Sure. Jeff, the midstream needs of course in the Utica will be very large. There will be both gathering needs, processing needs and further downstream transportation needs out of the basin. And the way that our model works is that we develop greenfield assets in our subsidiary which we call Chesapeake Midstream Development which we own 100% of and then over time, we look to drop those assets down into the MLP, Chesapeake Midstream Partners.

So, we are very early in the stages of designing and identifying what our build-out program will be in the Utica, but you can be assured that Chesapeake Midstream Development will be right in the middle of those plans and attempting to capture a big part of Chesapeake Operating Inc.'s production into its gathering system.

Jeff Robertson - *Barclays Capital - Analyst*

Thanks and then secondly, on the rig increases that you outlined, Aubrey, can you talk about how much of that is or would be supplied by redirecting gas rigs that you all currently own or do you all need to build new rigs or do you have enough with Bronco to meet most of your needs over the next several years?

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

Good question, Jeff. We typically set out to be able to meet about two-thirds of our drilling needs by our own fleet. So, today, we are at 115 and we are drilling with 168 rigs -- 167, whatever the number is.

So, we're probably a little short of the 67% mark. So over time we'll continue to add rigs as we have in the past and I think we'll probably end up doing those organically I think since we bought Bronco, the Rowan rigs went for much more than what we paid for the Bronco rigs and we think probably organically is the best way to do that.

So we'll continue to add but I don't think it's anything spectacular. But we would move you back to Nick's comment that on a recent analysis of our wells in the Eagle Ford, we can drill about 20% cheaper than others in the industry when we integrate our services.

One other thing we haven't talked about this morning but just to alert everybody, we will roll out on October 1st the first parts of our initial 250,000 hp fracture pressure pumping fleet. And so we will be pumping our first wells in the first couple of weeks of October. So, another way where we are addressing oilfield inflation and we'll do that through additional rigs. We'll do it through more horsepower. Remember, we need about 1 million hp a day and so that would give us the opportunity to build a pretty significant pressure pumping fleet over time.

Operator

Scott Wilmoth, Simmons & Co.

Scott Wilmoth - *Simmons & Company International - Analyst*

A few more details on the Utica leasehold position. Can you guys disclose your term lengths, what your cost position is in the play and are you looking to continue to add acreage?

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Aubrey McClendon - Chesapeake Energy Corporation - Chairman of the Board and CEO

Thanks, Scott. The answers are yes, we are continuing to acquire acreage in the field certainly in our strongholds. We're not working too much on the fringes where most other companies have moved into. I think I've said earlier on the call we've spent between \$1.5 billion and \$2 billion on leasehold to date and on length, generally we have a lot of HBP leases. We went in early and made deals on deep rights with a lot of shallow producers. Much of the acreage we acquired from EnerVest and the Anschutz. Some people may recall we made a deal with Anschutz last fall that did not meet with popular acclaim, but we knew we were getting a lot of Utica leasehold pretty cheaply in that.

So a lot of that is HBP. The stuff that we bought off the ground is mainly five plus five. So, we feel like we'll have no trouble getting it all HBP and won't have to be in as big a rush as we were in the Barnett and Haynesville although we recently do have more acreage here than we do need to get HBP.

Scott Wilmoth - Simmons & Company International - Analyst

Do you have a split of the HBP versus the 5 x 5 and what is your average royalty percentage across the play?

Aubrey McClendon - Chesapeake Energy Corporation - Chairman of the Board and CEO

I'm not going to give you that much detail. But I think if you look around in the field today and go check our leases, you might find net revenue interest for us is between 83 and 85%. That's kind of the usual which is pretty attractive given they are lower than that in Texas and Louisiana.

Scott Wilmoth - Simmons & Company International - Analyst

Okay and then when I think about a potential JV or you mentioned some alternative structure, would an alternative structure still have a component that you guys have used in a JV as you look to recover that initial cost basis at acreage or how are you thinking about that?

Aubrey McClendon - Chesapeake Energy Corporation - Chairman of the Board and CEO

I think any solution that we choose will have an upfront cash component to it and as part of our strategy, we find things, we go acquire the leasehold and then we bring bigger partners in. And bigger partners today are not just international energy companies but they are sometimes national and international financial companies as well. So, we want to get our money back for shareholders and de-risk the play and then accelerate the drilling. So, it needs to have both of those aspects towards it to be of interest to us.

Scott Wilmoth - Simmons & Company International - Analyst

Okay and then on a broader basis, you guys mentioned some liquids constraints in certain regions. Can you specify which basins you're seeing the most constraints and is that on the infrastructure side, the service side and is it focused on oil versus NGL or one or the other?

Aubrey McClendon - Chesapeake Energy Corporation - Chairman of the Board and CEO

It's not really on the service side. It's basically just waiting on pipelines and waiting on trucks. Again, we're not complaining and we're meeting the challenge and this week we holed our first oil ourselves so we're building 150 oil trucks ourselves to move the oil around and we've got big pipes coming on in the Eagle Ford Shale.

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So really across the board there's a shortage of oil hauling trucks, a shortage of drivers, a shortage of pipelines. But through our midstream entity and through our relationships with other midstream companies and then through our own service companies, we are out there meeting those logistical challenges.

So, we are sorry that we have had to move 2 million barrels from 2011 and 2012. We hoped that would not be possible but decided now is the time to recognize those constraints but we are going to work through them and work through them a lot with solutions that are homemade.

Scott Wilmoth - *Simmons & Company International - Analyst*

Then lastly just on the Haynesville, you mentioned rig count going down to 15 over time. At what time period do you get to that level? And then what is your outlook for the Haynesville production longer term over the next couple of years?

Steve Dixon - *Chesapeake Energy Corporation - EVP of Operations and Geosciences, and COO*

As Aubrey said, we've got nine of those rigs on their last well right now. We will be at 15 by December. That will have an effect on our production next year. We are not providing any guidance on that.

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

Well, I mean it's embedded in our production estimates. Whatever impact it has is simply that we won't grow our gas production near as much as we could have if we had kept 35 rigs running.

So, in fact if you go to slide 18 in our new slide deck that was posted this morning, you'll be able to see how our production grows over time and you'll see that virtually all of it is in oil and natural gas liquids and our gas production goes up a couple hundred MCF a day over the next year.

Scott Wilmoth - *Simmons & Company International - Analyst*

Yes, if I think I recall correctly, I think you guys gave a chart specific to the Haynesville at the analyst day and it looked like 12 was fairly flattish. Is that probably still the same fair assumption?

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

Yes, that's absolutely right, maybe even a little bit down over time. But again, I would emphasize, Scott, that if we are successful with our demand initiatives and you need more gas, we can ramp back up pretty quickly.

It's just at this point, we can make a lot more money with taking Haynesville rigs from the Haynesville and moving from moving them to the Utica or moving them to the Eagle Ford or Cleveland, Tonkawa or any of our other liquids plays.

Operator

Neal Dingmann, SunTrust.



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Neal Dingmann - *SunTrust Robinson Humphrey - Analyst*

Just a couple questions. First, back to the Utica, just -- they did add throughout the infrastructure. Just wondering about completion services in the area. Do you already have enough there? Will you be continuing to bring more in the region?

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

Neal, like everywhere we've been, we've moved in some areas where there's not much infrastructure there and we quickly overwhelm it. But again we're pretty good on logistics and so, where we go, service companies follow, including our own service company.

So, all delays and all challenges in a play like the Utica we've met before in the Barnett or we've met it in the Haynesville or we've met in the Eagle Ford. So we'll meet them here.

One thing I would say is the location of this play has a number of advantages to it. There's plenty of water.

The topography is much less challenging than say in West Virginia, Eastern PA. We're in a part of Ohio which frankly is ground zero for what used to be known as the manufacturing belt of America and unfortunately in the last 30 years has been the rust belt.

But we think that our activity can help rejuvenate this area and we're actually quite pleased with the quality of the workforce, the size of the workforce and we think of course there's great transportation alternatives here, and we're pretty close the Ohio River. So if we need to barge out some oil, we can do that.

So there are lots of advantages to doing business in Eastern Ohio. So if I could've picked another place for a play to develop, it's pretty much the most ideal place I could think of in America for a big new play to develop and we are excited about it and recognize that our activity is going to create a lot of logistical challenges. But, we'll meet them all and create tens of thousands of jobs while we do it.

Neal Dingmann - *SunTrust Robinson Humphrey - Analyst*

And then, Aubrey, in that area, will you target or I guess would say will you comingle some zones? Will you actually be going after some Marcellus as well as Utica? And then within the Utica, will you be targeting Point Pleasant or just the entire Utica?

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

I'll just leave it at this that we are focused on the Utica at this time.

Neal Dingmann - *SunTrust Robinson Humphrey - Analyst*

Okay and then just last question for you, just maybe a general comment not just only on the Utica, just overall on oilfield service costs in general as you see if maybe the remainder of the year -- kind of your thoughts about that.

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

You can have different thoughts. My thoughts are that we have seen the last of them or the worst of them I guess I should say as we and others put a lot of equipment into the field whether it be fracturing or whether it be the rigs or trucks.

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So the good news about service infrastructure bottlenecks, it can be solved pretty quickly, just call it 24 months or so. And I think that's the same problem with the problem we have at Cushing.

A lot of people are concerned about a long-term differential between WTI and LLS. But we think in 24 or 30 months, we'll have it -- we being the industry -- of which we'll be a participating part of that, I think we'll have that solved. So, Steve, are you worried about any big new increases in service costs?

Steve Dixon - Chesapeake Energy Corporation - EVP of Operations and Geosciences, and COO

No, I think their margins are plenty high today and there's a lot of equipment being built, a lot of horsepower in plays like the Haynesville that can get redirected? So I don't see any further inflation.

Operator

Bob Brackett, Bernstein Research.

Bob Brackett - Bernstein Research - Analyst

Question on the Utica monetization strategy. Would you prefer a JV with one of your existing partners, maybe a new partner or are you thinking royalty trust? Can you shed some light on that?

Aubrey McClendon - Chesapeake Energy Corporation - Chairman of the Board and CEO

Bob, I really can't. I mean, we have had repeat customers and we've had new customers and new partners.

So, I think for us it's whoever comes in the door with the most attractive offer for the opportunity that we've offered or the guys that we work with. We've worked with Frenchman. We've worked with Norwegians, we've worked with Americans, we've worked with British, we've worked with Chinese and we get along with them all quite well. Certainly it's stretched our cultural and language upbringing.

But it's all part of life. It's a good part of life I think. So we really don't have a preference. The process is underway and we look forward to a successful outcome for our shareholders.

Bob Brackett - Bernstein Research - Analyst

And so a royalty trust would be on the table?

Aubrey McClendon - Chesapeake Energy Corporation - Chairman of the Board and CEO

You know, royalty trusts are attractive and -- unless Nick wants to offer anything -- I'll just say we've filed one and I think probably we'll need to see how that goes and then decide where to go from there. Nick, do you have anything else you want to add?

Nick Dell'Osso - Chesapeake Energy Corporation - EVP and CFO

No. Just that, Bob, it's a product that requires a significant amount of proved reserves. So, if we were to pursue a royalty trust in the Utica, it would be quite a period of time before we had the proved reserves booked that would be required there.

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Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

It's a good solution to an asset like the Granite Wash or what SandRidge did in the Mississippi and we have a nice combination of proved reserves and also some PUDs. So, we don't have PUDs and we don't have PDP yet of any size in the Utica.

Operator

Dan Kiskis, Morgan Stanley.

Dan Kiskis - *Morgan Stanley - Analyst*

You guys had mentioned in the past that the rating agencies don't fully appreciate some of the things you've been doing like VPPs. Have you received any recent guidance from them to achieve budgeting metrics are caught by 2012?

Nick Dell'Osso - *Chesapeake Energy Corporation - EVP and CFO*

No, we haven't had any direct recent guidance from those guys, but we do stay in regular contact with them. They ask questions about our earnings release much in the same way as you guys do.

In fact I'm sure they are all listening this morning. And, we work with them on any number of questions that they have. So, no revised specific guidance but they are well up to speed on what we're doing.

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

And clearly we are increasing the credit worthiness of the Company really every quarter that goes by as our assets increase and our debt is now down to the \$10 billion number. So it will modulate up and down.

But we remain focused on delivering that value at the end of 2012 and just as Nick mentioned in his comments, we've had to abandon 130 in our 25/25 plan because our production is overrunning our estimates, we certainly hope that we can go with the 30/30 plan in 2012 and get our debt down even further.

So, that remains management's goal to make sure that your assets target \$10 billion of long-term debt at year-end 2012 and by that time, our proved reserves will be significantly higher than they are today and our EBITDA will be higher, all of our credit metrics will be quite a bit stronger year-end 2012 than they are even today.

Operator

Joe Allman, JPMorgan.

Joe Allman - *JPMorgan Chase & Co. - Analyst*

Aubrey, what was it that made you announce the Utica as a discovery in this release? Was it the production results from these three producing wells?

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Aubrey McClendon - Chesapeake Energy Corporation - Chairman of the Board and CEO

Yes, Joe, if you just kind of look at the opportunities we have to talk about things primarily, it's four times a year and that the last quarterly announcements at the end of April or first part of May, we didn't have producing wells and didn't think it was time to talk about it. We looked at the calendar and thinking three months from now it was too late.

So we just felt like it was the right time to answer some questions and to comment on some rumors that are out there. So, we would always like to say more rather than less when we can and this is one of those occasions when we feel like this is a nice first release of information about the play.

People can digest it and then over time, we'll be able to be more chatty and of course other companies will as well with their results. We expect other companies to start drilling wells pretty quickly and like the Eagle Ford and Haynesville and plays before it, things kind of go hockey stick here pretty soon with the information flow that comes out of the play.

Joe Allman - JPMorgan Chase & Co. - Analyst

That's helpful. So I'm assuming that your apparent excitement about this play is based on these three wells not just being clustered together. So I'm assuming these wells are somewhat spread apart. So can you talk about the distance between the furthest wells?

Aubrey McClendon - Chesapeake Energy Corporation - Chairman of the Board and CEO

Joe, I don't want to do you all's job for you, so I'll just say that you can go look at where our permits are and see that we're trying to spread our billing activity out. So we haven't gone out and drilled three wells right next to each other and then declared victory.

We've spread them across several counties. And remember also that this is not our first Shale rodeo, and so we now have a pretty good model of when you work up a geological and petrophysical model today, we know from working in the Barnett, the Haynesville, the Fayetteville, the Marcellus, Eagle Ford what's likely to happen. But you've got to wait until you drill your first wells and then when your first wells come in and they impress you, then you have quite a bit of confidence about your overall model.

So, we've tried to do a good job of spreading our wells out. We'll continue to test both the core of the play as well as the edges and we have drilled 15 wells.

So, we've got quite a bit of information and I don't know if you've thought about 3,200 feet of core, but three-fifths of a mile of rock that we've pulled and these are our wells -- this is proprietary core that we evaluated here at our reservoir technology center rather. So, we are quite confident about what we know about the play and what's likely to happen from here based on what we've seen in all of our other plays to date.

Joe Allman - JPMorgan Chase & Co. - Analyst

That's helpful. Then just back to the royalty trust question, for the Granite Wash one that you filed, I'm wondering why you did that. Is there not a cheaper source of financing available to you?

Aubrey McClendon - Chesapeake Energy Corporation - Chairman of the Board and CEO

I'll let Nick talk. I think the way the ones that I've seen so far trade, it's pretty attractive to be able to sell assets at basically PV-7 including a lot of PUDs. So I don't know if that's the right number. I'll let Nick focus on that.

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Nick Dell'Osso - *Chesapeake Energy Corporation - EVP and CFO*

It's a very attractive form of asset monetization similar to the VPP, there's a perversion of some tail interest here, there's some beneficial tax treatment associated with it. And at the end of the day, you get to monetize some assets for a very discrete asset.

One of the things we like about VPP's and royalty trusts is that you are selling well bores only and you are selling them within a defined depth. And one thing we've proven, as Aubrey talked about earlier today with Cleveland and Tonkawa, and we've talked about a lot with the washes in the past is that these basins where we have these large acreage positions, as we continue to evolve technology, we continue to find additional fantastic drilling opportunities and so, these are very discrete monetization vehicles and they allow us to capture value for projected production at a very low discount rate and frankly beat out what you would get in the A&D market if you were to go sell this asset where you would have to give up all the upside drilling associated with it and not get a whole lot more value for it.

Joe Allman - *JPMorgan Chase & Co. - Analyst*

That's helpful. And then just lastly, Aubrey, when you think about the various shale plays you're in, in terms of environmental risk, what are the biggest environmental risks that you concern you?

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

Joe, do you mean across all of our plays?

Joe Allman - *JPMorgan Chase & Co. - Analyst*

Really across all the plays. I think some of the ones in the Northeast get the most attention.

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

Yes I mean they are all well known. Obviously a lot of confusion about what we do on the hydraulic fracturing side and if you'd asked me a couple years ago would I ever be concerned about something we've done 15,000 times, somebody would object to it and I would've said no way. But, we've got some of those issues particularly in the East, not really in the Southwest and we were dealing with them I think successfully. Luckily, the claims about hydraulic fracturing are so incredibly over the top that all you have to do is kind of bring people out and show them what you do, show them the aftermath and then they kind of say well, what was I supposed to be really worried about here?

So, we deal with that. Certainly water consumption, water disposal are issues. But, again we continue to pursue solutions where we use less water, where we recycle more water.

And again, two years ago if you had asked me would we ever recycle water, I would ask you why would we ever need to do that. And today in a place like Pennsylvania, we are probably close to 100% water recycling.

Beyond that, maybe Steve can think of a few things but air emissions, we've certainly had to tighten up on the air emissions side of things and we're working with the industry and EPA to make sure that we are following best practices there. We're part of something called the STAR program which is run by the EPA which is targeting fugitive emissions and of course, for us that's cash into the air and, we want to stop fugitive emissions. So, those are the primary things I think and a little hurricane water over South Texas would be a good thing to help the Eagle Ford out right now.

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Operator

Biju Perincheril, Jefferies.

Biju Perincheril - *Jefferies & Company - Analyst*

I was hoping you could talk about your Bakken or Williston Basin activities a little bit. I saw some of your recent permitting which at least on some of the maps I've seen is a little farther than most of the other activities and maybe outside of the Bakken formation itself. Can you talk about the concept that you are targeting there?

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

Yes, sure. We are on the southern side of the Williston Basin. 10 or 15 years ago had assets in the central part of the basin drilling for more conventional targets and frankly just missed the Bakken and regret that of course.

But, Williston Basin is a big basin and I think we announced in the January conference call that we were building a position there. At the time, we had around 100,000 acres. I think we're up to 320,000 or so now and probably will push for 400,000.

As you correctly pointed out, we have permitted some wells. We haven't started to drill them yet. I think our first well spuds next week and I think our second one is within a couple of weeks after that and we start to add some rigs after that.

So I'm really not in a position to say much more about what we're targeting other than to be late to a basin like we were late to the Williston, you need to have perhaps a different idea than what other folks have. And so, we'll see if we have such an idea and we'll see if it works and hopefully we will have some results for you when we talk next.

Biju Perincheril - *Jefferies & Company - Analyst*

Okay, thanks. So now that you are up to over 300,000, does it now rise to a scale that depending on success maybe you'll look to bring in a partner?

Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

Yes, I think that's sufficient size. I think we have two other areas that are more urgent for us to get partners in and important for us to do and that's in the Utica and the Mississippi.

And so I think if you just kind of looked at how we've got things scheduled out, the Utica will be what we work on through the rest of the year here and Mississippi in the first part of 2012 and maybe a year from now or so we'll be working on a Williston solution as well.

Our acreage was acquired at a very attractive price up there. So, we really don't have an overwhelming need to de-risk it like when we go into the Utica and spend \$1.5 billion to \$2 billion. That's a significant risk for shareholders and we need to de-risk that in a play like the Williston where we haven't spent that much money yet.

Operator

There are no further questions at this time. I'll turn the conference back over to our presenters for any additional or closing comments.

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Aubrey McClendon - *Chesapeake Energy Corporation - Chairman of the Board and CEO*

Nothing further here. If you have additional questions, please direct them to John or to Jeff and we appreciate your interest in our Company. Thank you.

Operator

That does conclude today's conference. Thank you all for your participation.

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