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CHKR - Q3 2013 Chesapeake Granite Wash Trust Earnings Conference Call

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## CORPORATE PARTICIPANTS

**Nick Dell'Osso** *Chesapeake Granite Wash Trust - EVP, CFO*

**Jason Pigott** *Chesapeake Granite Wash Trust - SVP, Operations, Southern Division of Chesapeake*

## PRESENTATION

### Operator

Good day and welcome to the Chesapeake Granite Wash third-quarter 2013 distribution conference. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Nick Dell'Osso. Please go ahead.

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**Nick Dell'Osso** - *Chesapeake Granite Wash Trust - EVP, CFO*

Good morning and welcome to the Chesapeake Granite Wash Trust distribution conference call. This is Nick Dell'Osso, Executive Vice President and Chief Financial Officer of Chesapeake Energy. Also joining me for the call this morning is Jason Pigott, Senior Vice President, Operations, Southern Division of Chesapeake, and via teleconference is Sarah Newell, Vice President of Bank of New York Mellon Trust Company, the Trustee for Chesapeake Granite Wash Trust. We have a few prepared remarks and then we will take any questions you may have.

Please note that today's call will contain certain forward-looking statements and assumptions that are subject to inherit risks and uncertainties. The actual results may differ from those projected in the forward-looking statements. Additional information about risk factors and the other factors that could potentially affect the Trust and its financial results are included in the Trust's press release issued yesterday and in the Trust's filings with the SEC, including the 2013 third-quarter Form 10-Q the Trust filed yesterday.

In addition, we are under no obligation to update the forward-looking statements made during this call, and you should not place undue reliance on such statements.

As a reminder, CHKR is a Statutory Trust, which is required to distribute all cash flow after expenses. The Trust has no employees or officers and Chesapeake Energy, as the sponsor of the Trust, is responsible for operating the properties in which the Trust has an interest and fulfilling certain drilling commitments, which is also detailed in the Trust's filings with the SEC.

As stated in the press release yesterday afternoon, the distribution from CHKR for the third quarter of 2013, which primarily relates to production attributable to the Trust's royalty interests for the three-month period ended August 31, 2013, will be approximately \$0.67 per common unit. The common unit distribution will be paid on November 29, 2013 to unitholders of record at the close of business on November 19, 2013.

The calculated distribution for this period is approximately \$0.50 per unit, which is \$0.21 below the predetermined subordination threshold of \$0.71. For this distribution, all of the quarterly income available for distribution will be used to make a distribution per common unit of \$0.67, and the Trust will not pay a subordinated unit distribution for the quarter. Worth noting, Chesapeake Energy owns 100% of the subordinated units.

I will now turn the call over to Jason.

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**Jason Pigott** - *Chesapeake Granite Wash Trust - SVP, Operations, Southern Division of Chesapeake*

Thanks, Nick. For the three-month period of June 1, 2013 through August 31, 2013, total sales volumes attributed to the Trust royalty interest were 112,000 barrels of oil, a 15% sequential decrease; 294,000 barrels of natural gas liquids, a 10% sequential increase; and 2.7 billion cubic feet of natural gas, an 8% sequential decrease.

Total sales of approximately 849,000 barrels of oil equivalent were down 4% sequentially. Product mix in the three-month period ended August 31, 2013 was 13% oil, 35% NGL and 52% natural gas.

Realized prices for the period were \$99.41 per barrel of oil, \$30.97 per barrel of natural gas liquids, and \$2.51 per Mcf of natural gas. These prices include the effects of transportation and third-party deductions.

For the period, unhedged realized oil prices were higher by \$10.54 per barrel, natural gas liquids prices were lower by \$0.46 per barrel, and natural gas prices were lower by \$0.14 per Mcf when compared to the previous period.

Turning to hedges, actual NYMEX oil prices were above the swap contract prices held by the Trust, resulting in a realized loss on oil contracts of approximately \$2.8 million for the period. These fixed-price oil swap contracts were initially established to hedge approximately 50% of projected oil and natural gas liquids volumes. The use of crude oil derivatives to partially mitigate the price-risk of NGL production is subject to basis risk to the extent that oil and NGL prices are not highly correlated.

Initial forecasted revenue of the Trust assumed an NGL price at 49% of WTI. Actual NGL prices during the quarter were lower at 31% of WTI. The Trust has no natural gas hedges in place.

Turning to drilling results, in the Trust AMI, during the three-month period ended August 31, 2013, Chesapeake completed approximately six development wells as calculated under the development agreement, while running two rigs in the Trust AMI. Through October, Chesapeake has completed approximately 80 development wells, which is 68% of the total 118 development wells obligation.

As we noted during the first- and second-quarter 2013 conference call, we are continuing to analyze the recent underperformance of certain wells in the Trust AMI. We have learned that the reservoir permeability and sand body continuity within the Colony Granite Wash reservoir are higher than expected, which has resulted in lower-than-predicted reservoir pressure in some development well locations. This has resulted in lower initial production rates and lower recoverable reserves, as well as downward reserve revisions to some older drilled wells.

As previously reported, the Trust recognized a \$32.9 million impairment during the quarter ended March 31, 2013 and an impairment of \$11.2 million during the quarter ended June 30, 2013, primarily because of these results.

With a goal of improving average well performance in the Granite Wash, Chesapeake reduced its rig count in the AMI from four rigs to two rigs mid-August 2013. We believe this lower rate of development is prudent and will provide the Company more time to assess the performance of each new producing wellbore and to optimize future wellbore locations and intervals to be drilled. Because there is a finite number of wells remaining in the Trust to be drilled, Chesapeake's intent is to select the very best available locations and intervals in the Granite Wash formation.

While we believe this moderated pace of drilling could ultimately improve the economic returns to the Trust, the operated rig count reduction will decrease the rate at which the royalty income from the remaining development wells becomes available to the Trust for distribution. This will most likely result in continued distributions to common unitholders below the subordination threshold in the future.

I would like to conclude our prepared remarks by noting that Chesapeake owns 50.8% of the outstanding units in CHKR and holds an approximate 72% working interest in the Colony Granite Wash wells. Further, as 100% owner of the subordinated units of the Trust, Chesapeake's cash distributions from the Trust have been negatively impacted by the issues I have just described. We are heavily vested in the economic outcome of this play, and as operator, we are working very diligently to improve performance of these wells.

We will now take any questions you may have. Operator, please open up the line for Q&A.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). It looks like we have no questions at this time.



**Jason Pigott** - *Chesapeake Granite Wash Trust - SVP, Operations, Southern Division of Chesapeake*

Operator, thank you. To conclude, I would like to note that we do not plan to conduct quarterly investor conference calls going forward. The Trust will, however, continue to disclose detailed operational updates and quarterly distribution announcement press releases and filings with the SEC.

With that, I would like to wrap up the Chesapeake Granite Wash Trust distribution conference call.

**Operator**

That does conclude today's conference. We thank you for your participation.

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