

CHESAPEAKE ENERGY CORP

Form 424B5

September 07, 2005

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The information in this prospectus supplement is not complete and may be changed. This prospectus supplement and accompanying prospectus are not an offer to sell these securities and they are not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

Filed pursuant to Rule 424(b)(5)

Registration No. 333-119313

Subject to Completion, dated September 6, 2005

PROSPECTUS SUPPLEMENT

(To Prospectus dated August 12, 2005)

8,000,000 Shares

Chesapeake Energy Corporation

Common Stock

Our common stock is listed on the New York Stock Exchange under the symbol CHK. On September 6, 2005, the last reported sale price of our common stock was \$32.49 per share.

Investing in our common stock involves risks. See Supplemental Risk Factors beginning on page S-11 of this prospectus supplement and Risk Factors beginning on page 2 of the accompanying prospectus.

| | <u>Per Share</u> | <u>Total</u> |
|--|------------------|--------------|
| Public Offering Price | \$ | \$ |
| Underwriting Discount | \$ | \$ |
| Proceeds to Chesapeake (before expenses) | \$ | \$ |

We have granted the underwriters a 30-day option to purchase up to an additional 1,200,000 shares from us on the same terms and conditions as set forth above if the underwriters sell more than 8,000,000 shares of common stock in this offering.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved these securities or determined if this prospectus supplement or the prospectus to which it relates is truthful or complete. Any representation to the contrary is a criminal offense.

Lehman Brothers, on behalf of the underwriters, expects to deliver the shares on or about September , 2005.

Joint Book-Running Managers

LEHMAN BROTHERS

BANC OF AMERICA SECURITIES LLC

CREDIT SUISSE FIRST BOSTON

DEUTSCHE BANK SECURITIES

RAYMOND JAMES

Senior Co-Managers

BEAR, STEARNS & Co. INC.
MORGAN STANLEY

CITIGROUP
UBS INVESTMENT BANK

GOLDMAN, SACHS & Co.
WACHOVIA SECURITIES

Co-Managers

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GILFORD SECURITIES INCORPORATED
JEFFERIES & COMPANY, INC.

HARRIS NESBITT
JOHNSON RICE & COMPANY L.L.C.
SIMMONS & COMPANY INTERNATIONAL

HOWARD WEIL INCORPORATED
PRITCHARD CAPITAL PARTNERS, LLC

September , 2005

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You should rely only on the information contained in or incorporated by reference in this prospectus supplement and the accompanying prospectus. We have not authorized anyone to provide you with different information. We are not making an offer of these securities in any state where the offer is not permitted. You should not assume that the information contained in or incorporated by reference in this prospectus supplement or the accompanying prospectus is accurate as of any date other than the dates of this prospectus supplement or the accompanying prospectus or that any information we have incorporated by reference is accurate as of any date other than the date of the document incorporated by reference.

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PROSPECTUS SUPPLEMENT SUMMARY

This summary highlights selected information from this prospectus supplement and the accompanying prospectus, but may not contain all information that may be important to you. This prospectus supplement and the accompanying prospectus include specific terms of this offering, information about our business and financial data. We encourage you to read this prospectus supplement, the accompanying prospectus and the documents incorporated herein and therein in their entirety before making an investment decision. Unless otherwise indicated, this prospectus supplement assumes no exercise of the underwriters' over-allotment option.

Chesapeake

We are the third largest independent producer of natural gas in the U.S. and own interests in approximately 21,500 producing oil and gas wells. At June 30, 2005, approximately 90% of our proved reserves (by volume) were natural gas, and approximately 64% of our proved oil and natural gas reserves were located in our primary operating area—the Mid-Continent region of the United States, which includes Oklahoma, Arkansas, Kansas and the Texas Panhandle. In addition, we are building significant secondary operating areas in the South Texas and Texas Gulf Coast regions, the Permian Basin of West Texas and eastern New Mexico, the Barnett Shale area of north-central Texas and the Ark-La-Tex areas of East Texas and northern Louisiana.

As of December 31, 2004, our estimated proved reserves were 4,902 bcf. As of June 30, 2005, our internally estimated proved reserves had grown to 5,850 bcf, an increase of 948 bcf, or 19%. During the first half of 2005, we replaced our 218 bcf of production with an internally estimated 1,166 bcf of new proved reserves, for a reserve replacement rate of 535%. Reserve replacement through the drillbit was 583 bcf, or 268% of production (including 43 bcf from positive performance revisions and 25 bcf from oil and natural gas price increases), and reserve replacement through acquisitions was 583 bcf, or 267% of production.

From January 1, 1998 through June 30, 2005, we have been one of the most active consolidators of onshore U.S. natural gas assets, having purchased approximately 4.5 tcf of proved reserves at a total cost of approximately \$7.1 billion (including amounts paid for unproved leasehold but excluding \$809 million of deferred taxes in connection with certain corporate acquisitions), pro forma for our recent and pending acquisitions.

During the first half of 2005, we were especially active in the acquisitions market. Acquisition expenditures totaled \$1.8 billion in this period (including amounts paid for unproved leasehold but excluding \$252 million of deferred taxes in connection with certain corporate acquisitions), pro forma for our recent and pending acquisitions. Through these acquisitions, we will have acquired an internally estimated 696 bcf of proved oil and natural gas reserves at a cost of \$1.54 per mcf (excluding amounts paid for unproved leasehold and \$0.36 per mcf of deferred taxes in connection with certain corporate acquisitions).

During the first half of 2005, we led the nation in drilling activity with average utilization of 71 operated rigs and 65 non-operated rigs. Through this drilling activity, we drilled 413 (305 net) operated wells and participated in another 505 (60 net) wells operated by other companies and we added approximately 515 bcf of proved oil and natural gas reserves. Our success rate was 98% for both operated and non-operated wells. As of June 30, 2005, our proved developed reserves were 63% of our total proved reserves. In the first half of 2005, we invested \$118 million in leasehold (exclusive of leases acquired through acquisitions) and 3-D seismic data.

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We intend to use the net proceeds from this offering to repay amounts borrowed under our revolving bank credit facility. Please see Use of Proceeds.

Our executive offices are located at 6100 North Western Avenue, Oklahoma City, Oklahoma 73118, and our telephone number is (405) 848-8000.

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Business Strategy

Since our inception in 1989, our goal has been to create value for investors by building one of the largest onshore natural gas resource bases in the United States. For the past seven years, our strategy to accomplish this goal has been to build the dominant operating position in the Mid-Continent region, the third largest gas supply region in the U.S. In building this industry-leading position in the Mid-Continent, we have integrated an aggressive and technologically advanced drilling program with an active property consolidation program focused on small to medium-sized corporate and property acquisitions. We have also been building significant secondary operating areas in the South Texas and Texas Gulf Coast regions, the Permian Basin of West Texas and eastern New Mexico, the Barnett Shale area of north-central Texas and the Ark-La-Tex areas of East Texas and northern Louisiana. We believe significant elements of our successful Mid-Continent strategy have been transferred to these areas.

Key elements of this business strategy are further explained below:

Make High-Quality Acquisitions. Our acquisition program is focused on small to medium-sized acquisitions of natural gas properties that offer high-quality, long-lived production and significant development and higher potential deep drilling opportunities. From January 1, 1998 through June 30, 2005 pro forma for our recent and pending acquisitions, we have acquired \$5.6 billion of such proved properties (largely through 62 separate transactions of greater than \$10 million each) at an estimated average cost of \$1.23 per mcf of proved reserves (excluding amounts paid for unproved leasehold and \$0.18 per mcf of deferred taxes in connection with certain corporate acquisitions). The vast majority of these acquisitions either increased our ownership in existing wells or fields or added additional drilling locations in the Mid-Continent, and more recently in our secondary operating areas. Because our operating areas contain many smaller companies seeking liquidity opportunities and larger companies seeking to divest of non-core assets, we expect to continue to find additional attractive acquisition opportunities in the future.

Grow through the Drillbit. One of our most distinctive characteristics is our ability to increase reserves and production through the drillbit. We are currently utilizing 73 operated drilling rigs and 61 non-operated drilling rigs to conduct the most active drilling program in the United States. We focus both on finding significant new natural gas reserves and developing existing proved reserves, principally at deeper depths than the industry average. For the past seven years, we have been aggressively investing in leasehold, 3-D seismic information and human capital to be able to take advantage of the favorable drilling economics that exist today. While U.S. natural gas production has been declining during the past few years, we are one of the few mid- to large-cap companies that have been able to increase production, as we have successfully done for the past 15 consecutive years and 16 consecutive quarters. In the Mid-Continent, our drilling program remains the most active in the region and is supported by our ownership of the region's largest leasehold and 3-D seismic inventories.

Build Regional Scale. We believe one of the keys to success in the natural gas exploration industry is to build significant operating scale in a limited number of operating areas. Achieving such scale provides many benefits, the most important of which are higher per unit revenues, lower per unit operating costs, greater rates of drilling success, higher returns from more easily integrated acquisitions and higher returns on drilling investments. We first began pursuing this focused strategy in the Mid-Continent in late 1997 and we are now the largest natural gas producer, the most active driller and the most active acquirer of leasehold and producing properties in the Mid-Continent. We believe this region, which trails only the Gulf Coast and Rocky Mountain basins in current U.S. gas production, has many attractive characteristics. These characteristics include long-lived natural gas properties with predictable decline curves; multi-pay geological targets that decrease drilling risk and have resulted in a drilling success rate of 93% over the past sixteen years; favorable basis differentials to benchmark commodity

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prices; generally lower service costs than in more competitive or more remote basins; and a favorable regulatory environment with virtually no federal land ownership. We believe our secondary operating areas possess many of these same favorable characteristics.

Focus on Low Costs. By minimizing lease operating costs and general and administrative expense through focused activities and increased scale, we have been able to deliver attractive financial returns through all phases of the commodity price cycle. We believe our low cost structure is the result of management's effective cost-control programs, a high-quality asset base and the extensive and competitive services, gas processing and transportation infrastructures that exist in our key operating areas. As of June 30, 2005, we operated approximately 9,900 wells, or approximately 80% of our daily production.

Improve our Balance Sheet. We have made significant progress in improving our balance sheet over the past seven years. From December 31, 1998 through June 30, 2005, we have increased our shareholders' equity by \$4.1 billion (\$4.6 billion pro forma for our proposed offering of preferred stock and this offering) through a combination of earnings and common and preferred equity issuances. As of June 30, 2005, our debt as a percentage of total capitalization (total capitalization is the sum of debt and stockholders' equity) was 52%, compared to 137% as of December 31, 1998. As of June 30, 2005, on a pro forma basis for our recent private placement of senior notes, our proposed offering of preferred stock and this offering, our debt to total capitalization ratio was 50%. We plan to continue improving our balance sheet in the years ahead.

Based on our view that natural gas will be in a tight supply/high demand relationship in the U.S. during at least the next few years because of flat to declining supply and growing demand for this clean-burning, domestically-produced fuel, we believe our focused natural gas acquisition, exploitation and exploration strategy should provide substantial value-creating growth opportunities in the years ahead. Our goal is to increase our overall production by 10% to 20% per year, with growth at an annual rate of 5 to 10% generated organically through the drillbit and the remaining growth generated through future acquisitions. We have reached or exceeded this overall production goal in 10 of our 12 years as a public company.

Company Strengths

We believe the following six characteristics distinguish our past performance and differentiate our future growth potential from other independent natural gas producers:

High-Quality Asset Base. Our producing properties are characterized by long-lived reserves, established production profiles and an emphasis on onshore natural gas. Based upon current production and proved reserve estimates, and including estimates for our recent and pending acquisitions, our proved reserves-to-production ratio, or reserve life, is approximately 13 years. In each of our operating areas, our properties are concentrated in locations that enable us to establish substantial economies of scale in drilling and production operations and facilitate the application of more effective reservoir management practices. We intend to continue building our asset base in each of our operating areas through a balance of acquisitions, exploitation and exploration. As of June 30, 2005, we operated properties accounting for approximately 80% of our daily production volumes. This large percentage of operated properties provides us with a high degree of operating flexibility and cost control.

Low-Cost Producer. Our high-quality asset base, the work ethic of our employees, our hands-on management style and our location in Oklahoma City have enabled us to achieve a low operating and administrative cost structure. During the first half of 2005, our operating costs per unit of production were \$1.14 per mcfe, which consisted of general and administrative expenses of \$0.11 per mcfe (including non-cash stock-based compensation of \$0.02 per mcfe), production expenses of \$0.65 per mcfe and production taxes of \$0.38 per mcfe. We believe this is one of the lowest cost structures among publicly traded, mid- to large-cap independent oil and natural gas producers.

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Successful Acquisition Program. Our experienced asset acquisition team focuses on enhancing and expanding our existing assets in each of our operating areas. These areas are characterized by long-lived natural gas reserves, low lifting costs, multiple geological targets, favorable basis differentials to benchmark commodity prices, well-developed oil and gas transportation infrastructures and considerable potential for further consolidation of assets. Since 1998, and including our recently announced acquisitions, we have completed \$5.6 billion in acquisitions at an average cost of \$1.23 per mcfe of proved reserves (excluding amounts paid for unproved leasehold and \$0.18 per mcfe of deferred taxes in connection with certain corporate acquisitions). We believe we are well-positioned to continue making attractive small and medium-sized acquisitions as a result of our extensive track record of identifying, completing and integrating multiple successful acquisitions, our large operating scale and our knowledge and expertise in the regions in which we operate.

Large Inventory of Drilling Projects. During the 16 years since our inception, we have been among the five most active drillers of new wells in the United States. Presently we are the most active driller in the U.S. (with 73 operated and 61 non-operated rigs drilling) and the most active driller in the Mid-Continent (with 42 operated and 54 non-operated rigs drilling). Through this high level of activity over the years, we have developed an industry-leading expertise in drilling deep vertical and horizontal wells in search of large natural gas accumulations in challenging reservoir conditions. In addition, we believe that our large 10.8 million acre 3-D seismic inventory, much of which is proprietary to us, provides significant informational advantages over our competitors. As a result of our aggressive leasehold acquisition and seismic acquisition strategies, we have been able to accumulate an onshore leasehold position of approximately 4.1 million net acres and have acquired rights to 10.8 million acres of onshore 3-D seismic data to help evaluate our expansive acreage inventory. On this very large acreage position, our technical teams have identified 14,100 exploratory and developmental drill sites, representing a backlog of more than nine years of future drilling opportunities at current drilling rates.

Hedging Program. We have used and intend to continue using hedging programs to reduce the risks inherent in producing oil and natural gas, commodities that are frequently characterized by significant price volatility. We believe this price volatility is likely to continue in the years ahead and that we can use this volatility to our benefit by taking advantage of prices when they reach levels that management believes are either unsustainable for the long-term or provide unusually high rates of return on our invested capital. Between January 1, 2001 and June 30, 2005, we have increased our oil and gas revenues by over \$25.1 million from realized gains through our successful hedging programs, while significantly reducing the risks associated with our aggressive growth strategy during that time. We currently have gas hedges in place covering 69% of our anticipated gas production for the second half of 2005 and 37% of our anticipated gas production for 2006 at average NYMEX prices of \$7.17 and \$7.93 per mcf, respectively. In addition, we have 51% of our anticipated oil production hedged for the second half of 2005 and 51% of our anticipated oil production hedged for 2006 at average NYMEX prices of \$53.46 and \$59.65 per barrel of oil, respectively.

Entrepreneurial Management. Our management team formed the company in 1989 with an initial capitalization of \$50,000. Since then, our management team has guided the company through various operational and industry challenges and extremes of oil and gas prices to create the third largest independent producer of natural gas in the U.S. with an enterprise value of approximately \$16.4 billion (based on a common stock price of \$31.00 per share and pro forma for the pending preferred stock offering and this offering). Our co-founders, Aubrey K. McClendon and Tom L. Ward, have been business partners in the oil and gas industry for 22 years and beneficially own, as of September 6, 2005, approximately 19.5 million and 19.9 million of our common shares, respectively. They have each indicated an interest in purchasing up to \$10.0 million of common stock in this offering at the price offered to the public.

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Recent Developments

We recently announced a series of transactions intended to improve our capitalization.

Recent and Pending Acquisitions. In July 2005, we acquired oil and natural gas assets from Hallwood Energy III L.P. for cash consideration of approximately \$249.5 million. In addition, we have acquired or plan to acquire \$160 million of oil and natural gas assets in the third quarter of 2005. We believe these recent and pending acquisitions will add an internally estimated 113 bcfe to our proved reserves, 99% of which are natural gas and 45% of which are proved developed. These acquisitions are expected to initially add approximately 33 mmcf of natural gas equivalent to our daily production. Approximately \$210 million of the aggregate purchase price will be allocated to unproved properties. The properties are located in our secondary operating areas of the Barnett Shale, East Texas and the Permian Basin. We have closed all but one of the acquisitions scheduled to close in the third quarter of 2005. There is no assurance that the pending acquisition for approximately \$45.0 million will be completed or that our internal estimates of the reserves and production being acquired will prove correct.

Recent Private Offering of Senior Notes. On August 16, 2005, we completed a private placement of \$600 million of 6.50% Senior Notes due 2017. We used the net proceeds of this offering of approximately \$584.8 million to repay outstanding borrowings under our revolving bank credit facility.

Pending Public Offering of Preferred Stock. We are concurrently offering 2,500,000 shares of preferred stock (plus up to 375,000 additional shares subject to the underwriters' over-allotment option) pursuant to our existing shelf registration statement. Each share of preferred stock will be entitled to cumulative dividends of \$ payable quarterly, when, and if declared by our board of directors. Each share of preferred stock may be converted at any time, at the option of the holder into approximately shares of our common stock based upon an initial conversion price of \$ per common share, subject in each case to specified adjustments. The offering is expected to close concurrently with this offering and provide net proceeds of approximately \$242.9 million. The closing of this offering is conditioned on the closing of our pending public offering of preferred stock.

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The Offering

Common stock offered by Chesapeake 8,000,000 shares (1)

Common stock outstanding after this offering 337,110,208 shares (1) (2)

Use of Proceeds The net proceeds to us from this offering, after deducting discounts to the underwriters and estimated expenses of the offering, will be approximately \$238.5 million. Net proceeds to us, together with a portion of the net proceeds from our proposed public offering of preferred stock, are expected to be used to repay indebtedness under our revolving bank credit facility, which may be reborrowed for general corporate purposes, including to fund costs of our drilling program and our pending and possible future acquisitions. Please read Use of Proceeds.

New York Stock Exchange Symbol **CHK**

- (1) Excludes shares that may be issued to the underwriters pursuant to their over-allotment option. If the underwriters exercise their over-allotment option in full, the total number of shares of common stock offered will be 9,200,000, and the total number of shares of our common stock outstanding after this offering will be 338,310,208. We had 329,110,208 shares of our common stock outstanding at September 6, 2005.
- (2) Excludes shares of common stock potentially issuable upon the exercise of stock options, which as of September 6, 2005 included 20,735,860 shares potentially issuable upon the exercise of outstanding stock options at a weighted average price of \$6.15 and 6,556,065 shares of common stock reserved for issuance upon exercise of future additional options or awards of restricted stock, if granted under our stock compensation plans. Also excludes, as of September 6, 2005:

492,247 shares of common stock potentially issuable upon conversion of the 101,275 shares of our outstanding issue of 6.00% Cumulative Convertible Preferred Stock at an initial conversion price of \$10.287 per share;

9,681,863 shares of common stock potentially issuable upon conversion of the 1,588,180 shares of our outstanding issue of 5.00% Cumulative Convertible Preferred Stock (Series 2003) at an initial conversion price of \$16.40 per share;

9,965,309 shares of common stock potentially issuable upon conversion of the 165,935 shares of our outstanding issue of 4.125% Cumulative Convertible Preferred Stock at an initial conversion price of \$16.65 per share;

17,853,060 shares of common stock potentially issuable upon conversion of the 4,600,000 shares of our outstanding issue of 5.00% Cumulative Convertible Preferred Stock (Series 2005) at an initial conversion price of \$25.766 per share; and

5,329,341 shares of treasury stock.

Risk Factors

You should carefully consider all information in this prospectus supplement, the accompanying prospectus and the documents incorporated by reference herein. In particular, you should evaluate the specific risk factors set forth in the section entitled **Supplemental Risk Factors in this prospectus supplement and the section entitled **Risk Factors** in the accompanying prospectus for a discussion of risks relating to an investment in our common stock.**

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The following tables set forth summary consolidated financial data as of and for each of the three years ended December 31, 2004, 2003 and 2002 and six months ended June 30, 2005 and 2004. This data was derived from our audited consolidated financial statements included in our annual report on Form 10-K for the year ended December 31, 2004 and from our unaudited condensed consolidated financial statements included in our quarterly report on Form 10-Q for the six months ended June 30, 2005, each of which is incorporated by reference herein. The financial data below should be read together with, and are qualified in their entirety by reference to, our historical consolidated financial statements and the accompanying notes and the Management's Discussion and Analysis of Financial Condition and Results of Operations which are set forth in our annual report on Form 10-K.

| | Years Ended December 31, | | | Six Months Ended June 30, | |
|--|--------------------------|------------------|------------------|------------------------------|------------------|
| | 2004 | 2003 | 2002 | 2005 | 2004 |
| (unaudited) | | | | | |
| (\$ in thousands, except per share data) | | | | | |
| Statement of Operations Data: | | | | | |
| Revenues: | | | | | |
| Oil and gas sales | \$ 1,936,176 | \$ 1,296,822 | \$ 568,187 | \$ 1,311,343 | \$ 819,458 |
| Oil and gas marketing sales | 773,092 | 420,610 | 170,315 | 520,125 | 317,963 |
| Total revenues | 2,709,268 | 1,717,432 | 738,502 | 1,831,468 | 1,137,421 |
| Operating costs: | | | | | |
| Production expenses | 204,821 | 137,583 | 98,191 | 141,895 | 94,398 |
| Production taxes | 103,931 | 77,893 | 30,101 | 83,211 | 37,687 |
| General and administrative expenses: | | | | | |
| General and administrative (excluding stock-based compensation) | 32,217 | 22,808 | 17,262 | 18,932 | 15,586 |
| Stock-based compensation | 4,828 | 945 | 356 | 4,923 | 2,541 |
| Oil and gas marketing expenses | 755,314 | 410,288 | 165,736 | 507,279 | 310,779 |
| Oil and gas depreciation, depletion and amortization | 582,137 | 369,465 | 221,189 | 390,339 | 256,651 |
| Depreciation and amortization of other assets | 29,185 | 16,793 | 14,009 | 21,889 | 12,455 |
| Provision for legal settlements | 4,500 | 6,402 | | | |
| Total operating costs | 1,716,933 | 1,042,177 | 546,844 | 1,168,468 | 730,097 |
| Income from operations | 992,335 | 675,255 | 191,658 | 663,000 | 407,324 |
| Other income (expense): | | | | | |
| Interest and other income | 4,476 | 2,827 | 7,340 | 5,362 | 2,678 |
| Interest expense | (167,328) | (154,356) | (112,031) | (97,030) | (75,351) |
| Loss on repurchases or exchanges of Chesapeake debt | (24,557) | (20,759) | (2,626) | (69,300) | (6,925) |
| Loss on investment in Seven Seas | | (2,015) | (17,201) | | |
| Total other income (expense) | (187,409) | (174,303) | (124,518) | (160,968) | (79,598) |
| Income before income taxes and cumulative effect of accounting change | 804,926 | 500,952 | 67,140 | 502,032 | 327,726 |
| Income tax expense (benefit): | | | | | |
| Current | | 5,000 | (1,822) | | |
| Deferred | 289,771 | 185,360 | 28,676 | 183,243 | 117,981 |
| Total income tax expense | 289,771 | 190,360 | 26,854 | 183,243 | 117,981 |