

CHESAPEAKE ENERGY CORP

Form 424B2

July 27, 2004

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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)(2)**

**Registration No. 333-114916**

Subject to Completion, dated July 26, 2004

Prospectus Supplement

(To prospectus dated April 27, 2004)

**20,000,000 Shares**

## **Chesapeake Energy Corporation**

### **Common Stock**

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Our common stock is listed on the New York Stock Exchange under the symbol **CHK**. On July 23, 2004, the last reported sale price of our common stock was \$15.26 per share.

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Investing in our common stock involves risks. See **Supplemental Risk Factors** beginning on page S-10 of this prospectus supplement and **Risk Factors** beginning on page 2 of the accompanying prospectus.

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

The underwriters have an option to purchase up to an additional 3,000,000 shares of common stock on the same terms and conditions as set forth above solely to cover over-allotments, if any.

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.

Delivery of the shares of common stock will be made on or about August , 2004.

*Joint Book-Running Managers*

**Banc of America Securities LLC**

**Credit Suisse First Boston**

**Lehman Brothers**

**Raymond James**

*Senior Co-Managers*

**Bear, Stearns & Co. Inc.**

**Citigroup**

**Deutsche Bank Securities**

**Morgan Stanley**

**RBC Capital Markets**

**UBS Investment Bank**

*Co-Managers*

**Howard Weil Incorporated**

**Johnson Rice & Company L.L.C.**

**Morgan Keegan & Company, Inc.**

**Pritchard Capital Partners, LLC**

**Simmons & Company International**

July , 2004

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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 one of the five largest independent natural gas companies in the United States in terms of natural gas produced, owning interests in approximately 18,000 producing oil and gas wells. Our internally-estimated proved oil and natural gas reserves as of June 30, 2004, pro forma for our pending acquisition of Bravo Natural Resources, Inc. and our pending acquisition of assets from Legend Natural Gas, L.P., were approximately 4.1 tcf. Approximately 89% of our pro forma proved reserves by volume at June 30, 2004 were natural gas, and approximately 74% of our proved oil and natural gas reserves by volume at June 30, 2004 were located in our primary operating area—the Mid-Continent region of the United States, which includes Oklahoma, western Arkansas, southwestern Kansas and the Texas Panhandle. In addition, we are building significant operating areas in the Permian Basin of western Texas and eastern New Mexico, in the Ark-La-Tex basin of eastern Texas and northern Louisiana and in the South Texas and Texas Gulf Coast regions.

Since January 1, 1998, we have been one of the most active consolidators of onshore U.S. natural gas assets, having purchased or agreed to purchase approximately 3.6 tcf of proved reserves at a total cost of approximately \$4.3 billion (excluding \$461 million of deferred taxes in connection with certain corporate acquisitions). During 2004, we have remained active in the acquisitions market. In January 2004, we purchased Permian Basin and Mid-Continent oil and gas assets by acquiring privately-held Concho Resources Inc. for cash consideration of \$420 million (excluding employee severance and other miscellaneous costs). In June 2004, we acquired Greystone Petroleum LLC, a privately-held oil and natural gas company, for \$425 million in cash.

In July 2004, we made or agreed to make three acquisitions for a combined purchase price of \$590 million: privately-held Bravo Natural Resources, Inc., certain assets from Legend Natural Gas, LP and Tilford Pinson Exploration, LLC. Our internal estimates of proved reserves associated with these three acquisitions are 310 bcfe and current daily production is 60 mmcfe. Approximately 56% of these assets are located in the Mid-Continent and 44% are located in South Texas.

Bravo's assets are located in the Anadarko Basin of the Mid-Continent region, an area in which we are already very active. This stock acquisition is expected to close on August 2, 2004. Legend's assets are located in South Texas, 3 to 7 miles from our existing assets in Zapata County, Texas. This asset acquisition is expected to close on August 31, 2004. The Tilford Pinson assets are located in the Arkoma Basin of the Mid-Continent region, an area in which we are also very active.

Both the Bravo and Legend acquisitions are subject to customary closing conditions and there is no assurance that either of these pending acquisitions will be completed, or that our internal estimates of the reserves being acquired will prove correct.

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We also have completed five other smaller acquisitions in 2004 for \$165 million. Through these completed and announced 2004 acquisitions, we have acquired or agreed to acquire an internally estimated 879 bcfe of proved oil and natural gas reserves and added 187 mmcfe to our estimated daily production at a cost of \$1.47 per mcfe (excluding \$0.42 per mcfe of deferred taxes in connection with certain corporate acquisitions).

We intend to use the net proceeds from this offering, together with a portion of the proceeds from our pending private placement of senior notes discussed below, borrowings under our credit facility and cash on

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hand, to finance the Tilford Pinson acquisition and the pending Bravo and Legend acquisitions. This offering, however, is not conditioned on the closing of either of these pending acquisitions. Please read 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.

## **Business Strategy**

Since our inception in 1989, our goal has been to create value for our investors by building one of the largest onshore natural gas resource bases in the United States. For the past six 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 United States. 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 of up to \$600 million.

We are now building significant operating areas in the Permian Basin, Ark-La-Tex, South Texas and Texas Gulf Coast regions. These are areas to which we believe significant elements of our successful Mid-Continent strategy can be transferred. 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, primarily in the Mid-Continent, that offer high-quality, long-lived production and significant development and higher potential deeper drilling opportunities. Since January 1, 1998, we have acquired or agreed to acquire \$4.3 billion of such properties (largely through 41 separate transactions of greater than \$10 million each) at an estimated average cost of \$1.19 per mcf of proved reserves (including the acquisitions closed or announced in 2004 and excluding \$0.13 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 our primary Mid-Continent operating area, and more recently in our other operating areas. Because our operating areas contain many small companies seeking liquidity opportunities and larger companies seeking to divest 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 59 operated drilling rigs and 53 non-operated drilling rigs to conduct the most active drilling program in the United States, which is focused on finding significant new gas reserves and developing existing proved reserves primarily in the Mid-Continent, and principally at deeper depths than the industry average. For the past six years, we have been aggressively investing in acquiring the leasehold, the 3-D seismic information and the human capital to be able to take advantage of the favorable drilling economics that exist in our industry today. In an industry characterized by declining natural gas production during the past few years, we are one of the few mid- to large-cap companies that have been able to increase its production organically, as we have successfully done for the past 12 consecutive quarters. During the second half of 2004, we expect to use approximately 60-65 drilling rigs to drill approximately 300 company-operated wells and expect to utilize approximately 75-100 additional rigs to participate in the drilling of an additional 400 wells on outside-operated prospects. 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 undeveloped leasehold and 3-D seismic inventories. Across our operating areas, we seek a balanced approach to drilling with approximately one-third of our expenditures focused on targets located at depths shallower than 10,000 feet, one-third on medium depth drilling between 10-15,000 feet and one-third targeting deeper objectives below 15,000 feet.

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*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 core 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, a lower likelihood of making unsuccessful acquisitions and higher returns on invested capital. We first began pursuing this focused strategy in the Mid-Continent in 1997 and we are now the largest natural gas producer, the most active driller and the most active acquirer of undeveloped leases 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 an impressive drilling success rate of 92% over the past eleven years; favorable basis differentials to benchmark commodity 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 other operating areas possess many of these same favorable characteristics.

*Focus on Low Costs.* By minimizing lease operating costs and general and administrative expenses 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 service, gas processing and transportation infrastructures that exist in our key operating areas. We believe our acquisitions to date in 2004 will help maintain our low per unit operating and administrative costs because of our large existing scale of operations and the reimbursements we will receive from third parties in the approximately 1,150 newly acquired wells on which we have assumed operations. As of June 30, 2004, pro forma for our Tilford Pinson acquisition and our pending Bravo and Legend acquisitions, we operated approximately 7,500 wells, or approximately 78% of the value of our estimated pro forma proved reserves.

*Improve Our Balance Sheet.* We have made significant progress in improving our balance sheet over the past five years. From December 31, 1998 through March 31, 2004, we have increased our shareholders' equity by \$2.6 billion (\$2.9 billion pro forma for this offering) through a combination of earnings and common and preferred equity issuances. Our debt to total capitalization ratio has declined from 137% as of December 31, 1998 to 50% as of March 31, 2004, pro forma for our pending private placement of senior notes and this offering. 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/demand relationship in the United States during at least the next five years because of 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. Although U.S. gas production has been steadily declining during the past three years, we have increased our natural gas production in each of the past 12 quarters and in each of the 15 years since our inception in 1989. Our goal is to increase our overall production by 10% to 20% per year, with an estimated 5% of this growth generated organically through the drillbit and the remaining 5 to 15% generated through future acquisitions. We have reached or exceeded this overall production goal in 9 of our 11 years as a public company.

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### Company Strengths

We believe the following six characteristics distinguish our past performance and 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 natural gas. Based upon current production and year-end reserve estimates, including estimates for the acquisitions closed or announced in 2004, our proved reserves-to-production ratio, or reserve life, is approximately 11.2 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.

*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 six months ended June 30, 2004, our operating costs per unit of production were \$0.91 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 \$0.57 per mcfe and production taxes of \$0.23 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. We seek to control operations of the properties in which we own an interest. We operate properties accounting for approximately 78% of our pro forma proved reserves by value as of June 30, 2004. This large percentage of operated properties provides us with a high degree of operating flexibility and cost control.

*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 the Tilford Pinson acquisition and the pending Bravo and Legend acquisitions, we have completed \$4.3 billion in acquisitions at an average cost of \$1.19 per mcfe of estimated proved reserves (excluding \$0.13 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 15 years since our inception, we have been among the ten most active drillers of new wells in the United States. Presently we believe we are the most active driller in the United States (with 59 operated and 53 non-operated rigs drilling) and the most active driller in the Mid-Continent (with 44 of our 59 operated rigs). 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. We pursue deep drilling targets because of our view that most undiscovered gas reserves in the U.S. will be found at depths below 15,000 feet. In addition, we believe that our large 3-D seismic inventory, much of which is proprietary to us, provides us with significant advantages over our competitors, which largely prefer to drill shallower development wells. As a result of our aggressive land acquisition and seismic acquisition strategies, we have been able to accumulate an onshore leasehold position of approximately three million net acres and have acquired rights to over one million acres of 3-D seismic data to help evaluate our expansive acreage inventory. On this very large acreage position, our technical teams have identified over 5,000 exploratory and developmental drillsites, representing a backlog of more than seven years of future drilling opportunities.



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*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 and may even increase in the years ahead, but that we can use this volatility to our benefit by taking advantage of prices when they reach levels that management believes lock in unusually high rates of return on our invested capital. Between January 1, 2001 and June 30, 2004, we have increased our oil and gas revenues by \$154 million of net realized gains through our successful hedging programs. We currently have gas hedges in place covering 54% of our anticipated gas production for the second half of 2004 and 17% of our anticipated gas production for 2005, including production anticipated from our recent and pending acquisitions, at average NYMEX prices of \$5.20 and \$4.74 per mcf, respectively. In addition, we have 95% of our projected oil production hedged for the second half of 2004 and 9% of our projected oil production hedged for 2005 at average NYMEX prices of \$30.21 and \$31.56 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 current management team has guided the company through various operational and industry challenges and extremes of oil and gas prices to create one of the six largest independent producers of natural gas in the United States with an enterprise value of approximately \$7.6 billion (pro forma for this offering and our pending senior notes offering). Our co-founders, Aubrey K. McClendon and Tom L. Ward, have been business partners in the oil and gas industry for 21 years and beneficially own, as of July 21, 2004, approximately 16.0 million and 17.6 million of our common shares, respectively. They have each committed to purchase \$5 million of common stock in this offering at the price offered to the public, bringing their combined common and preferred stock purchases to \$110 million since the beginning of 2003.

### **Recent Financial Developments**

We recently announced the following developments:

*Financial and Operating Results.* On July 26, 2004, we announced our financial and operating results for the quarter ended June 30, 2004 together with an announcement of our pending acquisitions. We reported net income available to common shareholders of \$85.8 million, or \$0.31 per fully diluted common share, on total revenues of \$574.3 million for the second quarter of 2004, compared to net income available to common shareholders of \$76.3 million, or \$0.31 per fully diluted common share, on total revenues of \$429.8 million for the second quarter of 2003. Net income available to common shareholders for the second quarter of 2004 and 2003 includes a net unrealized after-tax (loss) gain of (\$7.1) million and \$2.0 million, or (\$0.02) and \$0.01 per fully diluted common share, respectively, resulting from our oil and natural gas and interest rate hedging programs.

We also reported production for the quarter ended June 30, 2004 of 86.5 bcfe, compared to production of 67.3 bcfe for the quarter ended June 30, 2003 and production of 78.9 bcfe for the quarter ended March 31, 2004. The increase of production for the second quarter of 2004 over production for the second quarter of 2003 consists of 7.7 bcfe generated from organic growth through drilling and 11.5 bcfe generated from acquisitions. Our production for the second quarter of 2004 was comprised of 76.5 bcf of natural gas and 1.67 mmbo of oil and natural gas liquids. During the second quarter of 2004, we replaced production with an internally estimated 429 bcfe of new oil and natural gas reserves, 143 bcfe of which was generated through drilling and 286 bcfe of which was generated through acquisitions.

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The following table sets forth certain consolidated financial data included in our July 26, 2004 announcement of financial and operating results for each of the three months ended June 30, 2004 and June 30, 2003.

	<b>Three Months</b>	
	<b>Ended June 30,</b>	
	<b>2003</b>	<b>2004</b>
	<b>(unaudited)</b>	
	<b>(in thousands, except per share data)</b>	
Total revenues	\$ 429,815	\$ 574,292
Total operating costs	259,913	395,012
Income from operations	169,902	179,280
Total other income (expense)	(37,255)	(27,471)
Income before income taxes	132,647	151,809
Income tax expense	50,407	54,654
Net income	82,240	97,155
Preferred stock dividends	(5,979)	(11,344)
Net income available to common shareholders	76,261	85,811
Earnings per common share - basic	\$ 0.36	\$ 0.36
Earnings per common share - assuming dilution	\$ 0.31	\$ 0.31

*Pending Private Offering of Senior Notes.* We are currently conducting a private placement of \$300 million of Senior Notes due 2014. Net proceeds are expected to be used to finance a portion of the Tilford Pinson acquisition and the pending acquisitions described above. There is no assurance that the offering will be completed or, if completed, completed for the amount contemplated. The closing of this offering is not conditioned on the closing of the senior notes offering.

Common stock offered by Chesapeake	20,000,000 shares(1)
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Common stock outstanding after this offering 264,470,142 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 \$ \_\_\_\_\_ million. Net proceeds are expected to be used to finance a portion of the pending Bravo and Legend acquisitions and to repay amounts outstanding under our existing bank credit facility incurred to finance the Tilford Pinson acquisition. If we are unable to complete either or both of the pending acquisitions, we will use the net proceeds allocated to such acquisition for general corporate purposes, including to fund costs of our drilling program 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 23,000,000. We had 244,470,142 shares of our common stock outstanding at July 21, 2004.
- (2) Excludes shares of common stock potentially issuable upon the exercise of stock options, which as of July 21, 2004 included 25,201,639 shares potentially issuable upon the exercise of outstanding stock options at a weighted average price of \$5.96 and 7,710,206 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 July 21, 2004:

19,466,214 shares of common stock potentially issuable upon conversion of the 2,997,800 shares of our outstanding issue of 6.75% Cumulative Convertible Preferred Stock at an initial conversion price of \$7.70 per share;

22,358,300 shares of common stock potentially issuable upon conversion of the 4,600,000 shares of our outstanding issue of 6.00% Cumulative Convertible Preferred Stock at an initial conversion price of \$10.287 per share;

10,515,945 shares of common stock potentially issuable upon conversion of the 1,725,000 shares of our outstanding issue of 5.00% Cumulative Convertible Preferred Stock at an initial conversion price of \$16.40 per share;

18,812,385 shares of common stock potentially issuable upon conversion of the 313,250 shares of our outstanding issue of 4.125% Cumulative Convertible Preferred Stock at an initial conversion price of \$16.65 per share;

422,527 shares of common stock potentially issuable upon exercise of warrants with a weighted average exercise price of \$14.55 per share; and

5,071,571 shares of treasury stock.

**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, 2001, 2002 and 2003 and the three months ended March 31, 2003 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, 2003, and from our unaudited condensed consolidated financial statements included in our quarterly report on Form 10-Q for the three months ended March 31, 2004, each of which are 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 and in our quarterly report on Form 10-Q, which are incorporated by reference herein.

	Years Ended December 31,			Three Months Ended March 31,	
	2001	2002	2003	2003	2004
	(unaudited)				
	(in thousands, except ratios and per share data)				
Statement of Operations Data:					
Revenues:					
Oil and gas sales	\$ 820,318	\$ 568,187	\$ 1,296,822	\$ 286,019	\$ 419,793
Oil and gas marketing sales	148,733	170,315	420,610	90,308	143,336
Total revenues	969,051	738,502	1,717,432	376,327	563,129
Operating costs:					
Production expenses	75,374	98,191	137,583	31,457	44,803
Production taxes	33,010	30,101	77,893	18,597	14,936
General and administrative expenses:					
General and administrative (excluding stock based compensation)	13,649	17,262	22,808	5,379	8,166
Stock based compensation	800	356	945		1,869
Oil and gas marketing expenses	144,373	165,736	410,288	89,358	139,664
Oil and gas depreciation, depletion and amortization	172,902	221,189	369,465	76,614	119,908
Depreciation and amortization of other assets	8,663	14,009	16,793	3,684	5,739
Provision for legal settlements			6,402	286	
Total operating costs	448,771	546,844	1,042,177	225,375	335,085
Income from operations	520,280	191,658	675,255	150,952	228,044
Other income (expense):					
Interest and other income	2,877	7,340	2,827	763	1,343
Interest expense	(98,321)	(112,031)	(154,356)	(37,004)	(46,545)
Loss on investment in Seven Seas		(17,201)	(2,015)		
Loss on repurchases or exchanges of debt	(76,667)	(2,626)	(20,759)		(6,925)
Impairment of investment in securities	(10,079)				
Gain on sale of Canadian subsidiary	27,000				
Gothic standby credit facility costs	(3,392)				
Total other income (expense)	(158,582)	(124,518)	(174,303)	(36,241)	(52,127)
Income before income taxes and cumulative effect of accounting change	361,698	67,140	500,952	114,711	175,917
Total income tax expense	144,292	26,854	190,360	43,591	63,327
Net income before cumulative effect of accounting change	217,406	40,286	310,592	71,120	112,590

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Cumulative effect of accounting change (net of income taxes of \$1,464,000)

			2,389	2,389	
Net income	217,406	40,286	312,981	73,509	112,590
Preferred stock dividends	(2,050)	(10,117)	(22,469)	(3,526)	(8,168)
Net income available to common shareholders	\$ 215,356	\$ 30,169	\$ 290,512	\$ 69,983	\$ 104,422

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	Three Months Ended				
	Years Ended December 31,			March 31,	
	2001	2002	2003	2003	2004
	(unaudited)				
	(in thousands, except ratios and per share data)				
Earnings per common share basic:					
Income before cumulative effect of accounting change	\$ 1.33	\$ 0.18	\$ 1.36	\$ 0.34	\$ 0.44
Cumulative effect of accounting change			0.02	0.01	
Net income	\$ 1.33	\$ 0.18	\$ 1.38	\$ 0.35	\$ 0.44
Earnings per common share assuming dilution:					
Income before cumulative effect of accounting change	\$ 1.25	\$ 0.17	\$ 1.20	\$ 0.31	\$ 0.38
Cumulative effect of accounting change			0.01	0.01	
Net income	\$ 1.25	\$ 0.17	\$ 1.21	\$ 0.32	\$ 0.38
Other Financial Data:					
Ratio of earnings to fixed charges(1)	4.4x	1.5x	4.0x	3.9x	4.9x
Ratio of earnings to fixed charges and preference dividends(1)	4.2x	1.3x	3.3x	3.4x	3.8x

### As of March 31, 2004

	As of December 31,			(unaudited)			
	2001	2002	2003	Historical	Pro Forma(2)	Pro Forma As Adjusted(3)	Pro Forma As Further Adjusted(4)
(in thousands)							
<b>Balance Sheet Data:</b>							
Total assets	\$ 2,286,768	\$ 2,875,608	\$ 4,572,291	\$ 5,557,462	\$ 5,899,287	\$ 6,187,592	\$ 6,494,787
Long-term debt, net of current maturities and discounts	1,329,453	1,651,198	2,057,713	2,012,147	2,316,774	2,306,954	2,614,149
Stockholders' equity	767,407	907,875	1,732,810	2,330,179	2,367,377	2,665,502	2,665,502

- (1) For purposes of determining the ratios of earnings to fixed charges and earnings to fixed charges and preference dividends, earnings are defined as net income before income taxes, cumulative effect of accounting changes, pre-tax gain or loss of equity investees, amortization of capitalized interest and fixed charges, less capitalized interest. Fixed charges consist of interest (whether expensed or capitalized and excluding the effect of unrealized gains or losses on interest rate derivatives), and amortization of debt expenses and discount or premium relating to any indebtedness. Preference dividends consist of preferred stock dividends grossed up to reflect the pre-tax amount.
- (2) On a pro forma basis to reflect (i) our May 2004 offering of senior notes and the application of \$288.6 million in net proceeds therefrom used to finance a portion of our Greystone acquisition completed June 2, 2004; (ii) the borrowings incurred under our bank credit facility and cash on hand used to finance a portion of our Greystone acquisition; (iii) cash on hand used to finance \$100 million of other acquisitions closed since March 31, 2004; and (iv) the exercise of the initial purchasers' over-allotment option in April 2004 in connection with our issuance of 4.125% preferred stock in March 2004.
- (3) Pro forma as adjusted to reflect the consummation of this offering.
- (4) Pro forma as further adjusted to reflect our pending private placement of \$300 million of senior notes and the application of the anticipated net proceeds, together with the net proceeds of this offering, to fund our Tilford Pinson acquisition and our pending Bravo and Legend acquisitions. In the event either the Bravo acquisition or the Legend acquisition is not completed, some or all of the net proceeds from our pending private placement of \$300 million of senior notes and this offering would be available to invest in our current drilling program and future acquisitions or repay bank indebtedness. As of July 21, 2004, we had \$354 million outstanding under our bank revolving credit facility. Please read Use of Proceeds.

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**SUPPLEMENTAL RISK FACTORS**

You should carefully consider the following factors as well as other information contained in this prospectus supplement, the accompanying prospectus and the documents we have incorporated herein by reference before deciding to invest in our common stock.

**Oil and gas prices are volatile. A decline in prices could adversely affect our financial results, cash flows, access to capital and ability to grow.**

Our revenues, operating results, profitability, future rate of growth and the carrying value of our oil and gas properties depend primarily upon the prices we receive for the oil and gas we sell. Prices also affect the amount of cash flow available for capital expenditures and our ability to borrow money or raise additional capital. The amount we can borrow from banks is subject to periodic redeterminations based on prices specified by our bank group at the time of redetermination. In addition, we may have ceiling test write-downs in the future if prices fall significantly.

Historically, the markets for oil and gas have been volatile and they are likely to continue to be volatile. Wide fluctuations in oil and gas prices may result from relatively minor changes in the supply of and demand for oil and natural gas, market uncertainty and other factors that are beyond our control, including:

worldwide and domestic supplies of oil and gas;

weather conditions;

the level of consumer demand;

the price and availability of alternative fuels;

the availability of pipeline capacity;

the price and level of foreign imports;

domestic and foreign governmental regulations and taxes;

the ability of the members of the Organization of Petroleum Exporting Countries to agree to and maintain oil price and production controls;

political instability or armed conflict in oil-producing regions; and



the overall economic environment.

These factors and the volatility of the energy markets make it extremely difficult to predict future oil and gas price movements with any certainty. Declines in oil and gas prices would not only reduce revenue, but could reduce the amount of oil and gas that we can produce economically and, as a result, could have a material adverse effect on our financial condition, results of operations and reserves. Further, oil and gas prices do not necessarily move in tandem. Because approximately 89% of our proved reserves at March 31, 2004 are natural gas reserves, we are more affected by movements in natural gas prices.

**Our level of indebtedness and preferred stock may adversely affect operations and limit our growth, and we may have difficulty making debt service and preferred stock dividend payments on our indebtedness and preferred stock as such payments become due.**

As of March 31, 2004, we had long-term indebtedness of \$2.0 billion (\$2.6 billion on a pro forma basis), with no amounts drawn under our \$500 million bank revolving credit facility. Our long-term indebtedness represented 46% of our total book capitalization at March 31, 2004. In May 2004, we issued \$300 million in aggregate principal amount of 7.50% Senior Notes due 2014. As of July 21, 2004, we had \$354 million outstanding under our bank revolving credit facility. We expect to continue to be highly leveraged in the foreseeable future.

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Our level of indebtedness and preferred stock affects our operations in several ways, including the following:

a significant portion of our cash flows must be used to service our indebtedness and pay dividends on preferred stock, and our business may not generate sufficient cash flow from operations to enable us to continue to meet our obligations under our indebtedness and our stated dividends on our preferred stock;

a high level of debt and preferred stock increases our vulnerability to general adverse economic and industry conditions;

the covenants contained in the agreements governing our outstanding indebtedness may limit our ability to borrow additional funds, dispose of assets, pay dividends and make certain investments;

our debt covenants may also affect our flexibility in planning for, and reacting to, changes in the economy and in our industry, and the rights and preferences applicable to our preferred stock may limit our ability to pay dividends on our common stock; and

a high level of debt and preferred stock may impair our ability to obtain additional financing in the future for working capital, capital expenditures, acquisitions, or other general corporate purposes.

We may incur additional debt, including significant secured indebtedness, or issue additional series of preferred stock, in order to make future acquisitions or to develop our properties. A higher level of indebtedness and additional preferred stock increases the risk that we may default on our existing debt obligations. Our ability to meet our debt obligations and to reduce our level of indebtedness depends on our future performance. General economic conditions, oil and gas prices and financial, business and other factors affect our operations and our future performance. Many of these factors are beyond our control. We may not be able to generate sufficient cash flow to pay the interest on our debt, and future working capital, borrowings or equity financing may not be available to pay or refinance such debt. Factors that will affect our ability to raise cash through an offering of our capital stock or a refinancing of our debt include financial market conditions, the value of our assets and our performance at the time we need capital.

In addition, our bank borrowing base is subject to periodic redeterminations. We could be forced to repay a portion of our bank borrowings due to redeterminations of our borrowing base. If we are forced to do so, we may not have sufficient funds to make such repayments. If we do not have sufficient funds and are otherwise unable to negotiate renewals of our borrowings or arrange new financing, we may have to sell significant assets. Any such sale could have a material adverse effect on our business and financial results.

**Competition in the oil and natural gas industry is intense, and many of our competitors have greater financial and other resources than we do.**

We operate in the highly competitive areas of oil and natural gas acquisition, development, exploitation, exploration and production. We face intense competition from both major and other independent oil and natural gas companies in each of the following areas:

seeking to acquire desirable producing properties or new leases for future exploration; and

seeking to acquire the equipment and expertise necessary to develop and operate our properties.

Many of our competitors have financial and other resources substantially greater than ours, and some of them are fully integrated oil companies. These companies may be able to pay more for development prospects and productive oil and natural gas properties and may be able to define, evaluate, bid for and purchase a greater number of properties and prospects than our financial or human resources permit. Our ability to develop and exploit our oil and natural gas properties and to acquire additional properties in the future will depend upon our ability to successfully conduct operations, evaluate and select suitable properties and consummate transactions in this highly competitive environment.

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**Our hedging activities may reduce the realized prices received for our oil and gas sales and require us to provide collateral for hedging liabilities.**

In order to manage our exposure to price volatility in marketing our oil and gas, we enter into oil and gas price risk management arrangements for a portion of our expected production. Commodity price hedging may limit the prices we actually realize and therefore reduce oil and gas revenues in the future. The fair value of our oil and gas derivative instruments outstanding as of March 31, 2004 and June 30, 2004 was a liability of approximately \$169 million and \$196 million, respectively. In addition, our commodity price risk management transactions may expose us to the risk of financial loss in certain circumstances, including instances in which:

our production is less than expected;

there is a widening of price differentials between delivery points for our production and the delivery point assumed in the hedge arrangement; or

the counterparties to our contracts fail to perform under the contracts.

Some of our commodity price and interest rate risk management arrangements require us to deliver cash collateral or other assurances of performance to the counterparties in the event that our payment obligations exceed certain levels. As of March 31, 2004, we were required to post a total of \$75.0 million of collateral with our counterparties through letters of credit issued under our bank credit facility with respect to commodity price and financial risk management transactions. As of July 21, 2004, we were required to post a total of \$72 million of collateral. Future collateral requirements are uncertain and will depend on arrangements with our counterparties, highly volatile natural gas and oil prices and fluctuations in interest rates.

**The actual quantities and present value of our proved reserves may prove to be lower than we have estimated.**

This prospectus supplement and the documents incorporated by reference herein contain estimates of our proved reserves and the estimated future net revenues from our proved reserves and estimates relating to pending acquisitions. These estimates are based upon various assumptions, including assumptions required by the SEC relating to oil and gas prices, drilling and operating expenses, capital expenditures, taxes and availability of funds. The process of estimating oil and gas reserves is complex. The process involves significant decisions and assumptions in the evaluation of available geological, geophysical, engineering and economic data for each reservoir. Therefore, these estimates are inherently imprecise.

Actual future production, oil and gas prices, revenues, taxes, development expenditures, operating expenses and quantities of recoverable oil and gas reserves most likely will vary from these estimates. Such variations may be significant and could materially affect the estimated quantities and present value of our proved reserves. In addition, we may adjust estimates of proved reserves to reflect production history, results of exploration and development drilling, prevailing oil and gas prices and other factors, many of which are beyond our control. Our properties may also be susceptible to hydrocarbon drainage from production by operators on adjacent properties.

At December 31, 2003, approximately 26% of our estimated proved reserves by volume were undeveloped. Recovery of undeveloped reserves requires significant capital expenditures and successful drilling operations. These reserve estimates include the assumption that we will make significant capital expenditures to develop the reserves, including \$351 million in 2004. You should be aware that the estimated costs may not be

accurate, development may not occur as scheduled and results may not be as estimated.

You should not assume that the present values referred to in this prospectus supplement and the documents incorporated by reference in this prospectus supplement represent the current market value of our estimated oil and gas reserves. In accordance with SEC requirements, the estimates of our present values are based on prices and costs as of the date of the estimates. The December 31, 2003 present value is based on weighted average oil and gas prices of \$30.22 per barrel of oil and \$5.68 per mcf of natural gas. Actual future prices and costs may be materially higher or lower than the prices and costs as of the date of an estimate.

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Any changes in consumption by oil and gas purchasers or in governmental regulations or taxation will also affect actual future net cash flows.

The timing of both the production and the costs for the development and production of oil and gas properties will affect both the timing of actual future net cash flows from our proved reserves and their present value. In addition, the 10% discount factor, which is required by the SEC to be used in calculating discounted future net cash flows for reporting purposes, is not necessarily the most accurate discount factor. Future interest rates and the risks associated with our business or the oil and gas industry in general will affect the accuracy of the 10% discount factor.

**Reserve estimates of properties acquired in 2004 have not been prepared by independent petroleum engineers. Our internal estimates may not be as reliable as estimates of those reserves by independent engineers.**

Our estimates of proved reserves attributed to our 2004 acquisitions, including our pending Bravo and Legend acquisitions, included herein or incorporated by reference in this prospectus supplement have not been reviewed or reported on by independent petroleum engineers. These estimates were prepared by our own engineers and professionals using criteria otherwise in compliance with SEC rules. Furthermore, our internal reserve estimates for these acquisitions are based upon data available to us which may not be as complete as data available on our other properties. Oil and gas pricing can affect estimates of quantities of proved reserves due to the impact of pricing on ultimate economic recovery. Estimates prepared by independent engineers might be different than our internal estimates.

**We may not have funds sufficient to make the significant capital expenditures required to replace our reserves.**

Our exploration, development and acquisition activities require substantial capital expenditures. Historically, we have funded our capital expenditures through a combination of cash flows from operations, our bank credit facility and debt and equity issuances. Future cash flows are subject to a number of variables, such as the level of production from existing wells, prices of oil and gas, and our success in developing and producing new reserves. If revenue were to decrease as a result of lower oil and gas prices or decreased production, and our access to capital were limited, we would have a reduced ability to replace our reserves. If our cash flows from operations are not sufficient to fund our capital expenditure budget, we may not be able to access additional bank debt, debt or equity or other methods of financing to meet these requirements.

**If we are not able to replace reserves, we may not be able to sustain production.**

Our future success depends largely upon our ability to find, develop or acquire additional oil and gas reserves that are economically recoverable. Unless we replace the reserves we produce through successful development, exploration or acquisition activities, our proved reserves will decline over time. In addition, approximately 26% of our total estimated proved reserves by volume at December 31, 2003 were undeveloped. By their nature, estimates of undeveloped reserves are less certain. Recovery of such reserves will require significant capital expenditures and successful drilling operations. We may not be able to successfully find and produce reserves economically in the future. In addition, we may not be able to acquire proved reserves at acceptable costs.

**Our pending acquisitions may not close as anticipated.**

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While we expect that our pending Bravo and Legend acquisitions will close by August 31, 2004 without material reduction in value or size, this offering is not conditioned on the closing of either acquisition and these acquisitions may not ultimately close. The closing of the Bravo and Legend acquisitions are subject to customary closing conditions, including review of title and environmental issues to determine whether closing

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representations and warranties are true. The closing prices of the Bravo and Legend acquisitions are subject to adjustment for certain items. We do not believe these adjustments, if made, would have a significantly adverse effect on the Bravo and Legend acquisitions or materially reduce the amount of acquired reserves.

### **Acquisitions may prove to be worth less than we paid because of uncertainties in evaluating recoverable reserves and potential liabilities.**

A significant portion of our recent growth is due to acquisitions of exploration and production companies, producing properties and undeveloped leasehold. We expect acquisitions will also contribute to our future growth. Successful acquisitions require an assessment of a number of factors, including estimates of recoverable reserves, exploration potential, future oil and gas prices, operating costs and potential environmental and other liabilities. Such assessments are inexact and their accuracy is inherently uncertain. In connection with our assessments, we perform a review of the acquired properties, which we believe is generally consistent with industry practices. However, such a review will not reveal all existing or potential problems. In addition, our review may not permit us to become sufficiently familiar with the properties to fully assess their deficiencies and capabilities. We do not inspect every well. Even when we inspect a well, we do not always discover structural, subsurface and environmental problems that may exist or arise.

We are generally not entitled to contractual indemnification for preclosing liabilities, including environmental liabilities. Normally, we acquire interests in properties on an as is basis with limited remedies for breaches of representations and warranties.

Competition for producing oil and gas properties is intense and many of our competitors have financial and other resources that are substantially greater than those available to us. Therefore, we may not be able to acquire oil and gas properties that contain economically recoverable reserves or be able to complete such acquisitions on acceptable terms.

Additionally, significant acquisitions can change the nature of our operations and business depending upon the character of the acquired properties, which may have substantially different operating and geological characteristics or be in different geographic locations than our existing properties. Our current intention is to continue focusing on acquiring properties with development and exploration potential located in the Mid-Continent, South Texas, Ark-La-Tex and Permian regions. To the extent that we acquire properties substantially different from the properties in our primary operating regions or acquire properties that require different technical expertise, we may not be able to realize the economic benefits of these acquisitions as efficiently as in our prior acquisitions.

### **Future price declines may result in a write-down of our asset carrying values.**

We utilize the full cost method of accounting for costs related to our oil and gas properties. Under this method, all such costs (for both productive and nonproductive properties) are capitalized and amortized on an aggregate basis over the estimated lives of the properties using the unit-of-production method. However, these capitalized costs are subject to a ceiling test, which limits such pooled costs to the aggregate of the present value of future net revenues attributable to proved oil and gas reserves discounted at 10% plus the lower of cost or market value of unproved properties. The full cost ceiling is evaluated at the end of each quarter using the prices for oil and gas at that date, adjusted for the impact of derivatives accounted for as cash flow hedges. A significant decline in oil and gas prices from current levels, or other factors, without other mitigating circumstances, could cause a future write-down of capitalized costs and a non-cash charge against future earnings. Our aggregate present value of future net revenues plus the value of the unproved properties would equal the recorded net book value of our oil and gas properties at December 31, 2003, assuming an index price of approximately \$3.25 per mcf for gas and \$32.25 per barrel for oil. If index prices were to fall below these levels, we could experience a writedown of the book value of our oil and gas assets.



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### **Oil and gas drilling and producing operations are hazardous and expose us to environmental liabilities.**

Oil and gas operations are subject to many risks, including well blowouts, cratering and explosions, pipe failure, fires, formations with abnormal pressures, uncontrollable flows of oil, natural gas, brine or well fluids, and other environmental hazards and risks. Our drilling operations involve risks from high pressures and from mechanical difficulties such as stuck pipes, collapsed casings and separated cables. If any of these risks occurs, we could sustain substantial losses as a result of:

injury or loss of life;

severe damage to or destruction of property, natural resources and equipment;

pollution or other environmental damage;

clean-up responsibilities;

regulatory investigations and penalties; and

suspension of operations.

Our liability for environmental hazards includes those created either by the previous owners of properties that we purchase or lease or by acquired companies prior to the date we acquire them. We maintain insurance against some, but not all, of the risks described above. Our insurance may not be adequate to cover casualty losses or liabilities. Also, in the future we may not be able to continue to obtain insurance at premium levels that justify its purchase.

### **Exploration and development drilling may not result in commercially productive reserves.**

We do not always encounter commercially productive reservoirs through our drilling operations. The new wells we drill or participate in may not be productive and we may not recover all or any portion of our drilling costs. The seismic data and other technologies we use do not allow us to know conclusively prior to drilling a well that oil or gas is present or may be produced economically. The cost of drilling, completing and operating a well is often uncertain, and cost factors can adversely affect the economics of a project. Our efforts will be unprofitable if we drill dry wells or wells that are productive but do not produce enough reserves to return a profit after drilling, operating and other costs. Further, our drilling operations may be curtailed, delayed or canceled as a result of a variety of factors, including:

unexpected drilling conditions;

title problems;

pressure or irregularities in formations;

equipment failures or accidents;

adverse weather conditions;

compliance with environmental and other governmental requirements; and

the high cost or shortages or delays in the availability of drilling rigs and equipment.

**The loss of key personnel could adversely affect our ability to operate.**

We depend, and will continue to depend in the foreseeable future, on the services of our officers and key employees with extensive experience and expertise in evaluating and analyzing producing oil and gas properties and drilling prospects, maximizing production from oil and gas properties, marketing oil and gas production, and developing and executing financing and hedging strategies. Our ability to retain our officers and key employees is important to our continued success and growth. The unexpected loss of the services of one or more of these individuals could have a detrimental effect on our business. We do not maintain key person life insurance on any of our personnel.

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**Lower oil and gas prices could negatively impact our ability to borrow.**

Our bank credit facility limits our borrowings to \$500 million based on current bank commitments as of the date of this prospectus supplement. The borrowing base, currently \$600 million, is determined periodically at the discretion of a majority of the banks and is based in part on oil and gas prices. Additionally, some of our indentures contain covenants limiting our ability to incur indebtedness in addition to that incurred under our bank credit facility. These indentures limit our ability to incur additional indebtedness unless we meet one of two alternative tests. The first alternative is based on our adjusted consolidated net tangible assets, which is determined using discounted future net revenues from proved oil and gas reserves as of the end of each year. The second alternative is based on the ratio of our adjusted consolidated EBITDA (as defined in all of our indentures) to our adjusted consolidated interest expense over a trailing twelve-month period. As of the date of this prospectus supplement, we are permitted to incur significant additional indebtedness under both of these debt incurrence tests. Lower oil and gas prices in the future could reduce our adjusted consolidated EBITDA, as well as our adjusted consolidated net tangible assets, and thus could reduce our ability to incur additional indebtedness.

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**USE OF PROCEEDS**

The net proceeds from this offering will be approximately \$            million, after deducting underwriters' discounts and commissions and the estimated expenses of the offering. We intend to use the net proceeds from this offering together with the net proceeds from our pending private placement of \$300 million of our senior notes to finance the pending Bravo and Legend acquisitions, which are both subject to the satisfaction of customary closing conditions, to repay any amounts outstanding under a short term standby facility, which we may use to finance the Bravo acquisition, and to repay amounts outstanding under our bank revolving credit facility incurred to finance the Tilford Pinson acquisition.

If we have any remaining net proceeds, or if we are unable to complete either or both of the Bravo and Legend acquisitions, the remaining net proceeds will be used by us for general corporate purposes, including to fund costs of our drilling program and possible future acquisitions. Pending such use, we will use a portion of the net proceeds from this offering and the pending debt offering to repay a portion of the \$354 million outstanding under our bank revolving credit facility as of July 21, 2004.

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The following table shows our unaudited capitalization as of March 31, 2004:

on a historical basis;

on a pro forma basis to reflect (i) our May 2004 offering of senior notes and the application of \$288.6 million in net proceeds therefrom used to finance a portion of our Greystone acquisition completed June 2, 2004; (ii) the borrowings incurred under our bank credit facility and cash on hand used to finance a portion of our Greystone acquisition; (iii) cash on hand used to finance \$100 million of other acquisitions closed since March 31, 2004; and (iv) the exercise of the initial purchasers' over-allotment option in April 2004 in connection with our issuance of 4.125% preferred stock in March 2004;

on a pro forma basis as adjusted to reflect the consummation of this offering at an assumed offering price of \$15.50 per share (assuming no exercise of the underwriters' over-allotment option); and

on a pro forma basis as further adjusted to reflect our pending \$300 million private placement of senior notes and the application of the anticipated net proceeds, together with the net proceeds from this offering, to fund our Tilford Pinson acquisition and our pending Bravo and Legend acquisitions.

This table should be read in conjunction with, and is qualified in its entirety by reference to, our historical financial statements and the accompanying notes included in our annual report on Form 10-K for the year ended December 31, 2003, and our quarterly report on Form 10-Q for the quarter ended March 31, 2004, which are incorporated by reference herein.

	As of March 31, 2004			
	Historical	Pro Forma	Pro Forma As Adjusted	Pro Forma As Further Adjusted(1)
	(in thousands)			
Cash and cash equivalents	\$ 189,425	\$	\$ 288,305	\$
Long-term debt:				
Bank revolving credit facility	\$	\$ 9,820	\$	\$ 7,195
8.375% Senior Notes due 2008	209,815	209,815	209,815	