



## **Letter to Shareholders**

Fiscal 1993 was a year of major change for Chesapeake Energy Corporation as we made the transition from private to public ownership. This transition has set the stage for future earnings and asset growth. The success of Chesapeake's initial public offering (IPO) in February 1993 was an important step in implementing our plan for increased profitability and growth for the company. Chesapeake received net proceeds of approximately \$25.2 million from the public offering of 2.3 million shares of the company's common stock. This offering, allowed the company to significantly reduce long-term debt and improve working capital.

### **CORPORATE STRATEGY**

Chesapeake's business strategy is based on our view that the ownership and development of domestic energy reserves, particularly natural gas, will create substantial benefits to our shareholders. To maximize those benefits, we have concentrated our efforts in three areas.

First, we have acquired more than 100,000 gross acres of prospective undeveloped leasehold in our primary operating areas. With our projected drilling schedule of 40-50 wells per year, this undeveloped leasehold should provide the company with three to five years of low-risk drilling opportunities.

Second, Chesapeake continues to be one of the leaders in the application of advanced horizontal drilling techniques. We are now drilling opposing and stacked laterals from a single vertical wellbore. Technical advances such as these have helped lower horizontal drilling costs by approximately 25% during the past year. This trend should continue as we incorporate more innovations in this rapidly expanding area of high technology.

Third, the alliances we have created with larger energy companies, such as Amerada Hess, Mobil, Texaco and Union Pacific Resources Company, demonstrate the quality of Chesapeake's asset base and the innovative spirit of management. For example, Chesapeake recently announced joint development and financing agreements with Union Pacific in the Giddings Field which could lead to the risk-free development of as much as 18 to 30 billion cubic feet of gas equivalent (BCFE); net to the company's interest.

Additionally, in early 1994 Chesapeake plans to begin operations on a horizontal drilling project in southern Oklahoma with Texaco and Mobil as our partners. If successful, the venture could significantly increase the company's inventory of low-risk developmental opportunities.

## **CHESAPEAKE'S STRENGTH**

Since inception, Chesapeake's strength has been the acquisition and development of high quality undeveloped properties. In this regard, we have concentrated our efforts in two primary operating areas: the Giddings Field in southern Texas and the Golden Trend Field in southern Oklahoma.

Our use of advanced seismic, drilling and completion technologies in these fields has enabled Chesapeake to increase its annual production by more than 2600% during the past four years. We believe our technical capabilities and leasehold inventory will continue to provide substantial growth opportunities in the next several years.

Although constrained by limited capital, we nevertheless enjoyed operational success in fiscal 1993. During the year, we drilled 37 wells, 34 of which were commercially productive. The company's production for the year increased by 24% to 4.3 BCFE and total company reserves also grew to an all-time high of 137.5 BCFE. Additionally, revenues from oil and gas sales increased 10% despite an 11% decrease in average oil and gas prices.

Chesapeake's finding costs for fiscal 1993 were approximately \$0.85 per thousand cubic feet of gas equivalent (MCFE) in our primary operating areas and \$1.07 per MCFE overall. These attractive finding costs and attractive development opportunities enabled the company to reinvest its cash flow in finding additional reserves. With a capital budget for new wells of only \$7.4 million, we were still able to replace 176% of our production in 1993.

This was achieved even though the increased drilling activity that resulted from our IPO did not materially affect our operating-results in fiscal 1993. However, we are now seeing the benefits of increased drilling activity. In the first quarter of fiscal 1994, net production was up 56% compared to the first fiscal quarter of 1993. For all of fiscal 1994 we anticipate increasing production volumes by more than 50% over the previous year. This trend should provide excellent earnings and cash flow increases, creating strong momentum for per share value growth.

## **FINANCIAL RESULTS**

Despite reporting a loss \$365,000 in fiscal 1993, we believe the strength of our management team and our strategy of growth through drilling will translate into improved financial results in fiscal 1994.

To a large degree, the company's earnings decline in 1993 was the result of a special charge of \$1.3 million as a provision for litigation expense and legal settlements. Although distasteful, the settlements have now allowed management to focus its efforts on enhancing shareholder value through the development of the company's large reserve base.

During the past four fiscal years we have increased our revenues from \$0.6 million to \$18.0 million, increased our annual production from 0.2 BCFE to 4.3 BCFE, increased total assets from \$7.5 million to \$77.8 million, and enlarged our proved reserve base from 10.9 BCFE to 137.5 BCFE.

These four-year growth rates are among the highest in the independent energy sector. As our capital requirements are met, we expect impressive rates of growth to continue.

## **OUTLOOK FOR OUR FUTURE**

Some of our peers are spreading their drilling budgets across both domestic and international drilling projects. We believe this is an inappropriate strategy for a medium-sized independent producer. Therefore, Chesapeake has focused virtually all of its fiscal 1994 capital budget on developmental drilling in the Giddings and Golden Trend Fields, two of the most active fields in the nation and areas where we have historically performed well.

Our goals for 1994 and beyond remain ambitious. We believe the rest of the decade will be rewarding for well-managed, gas-leveraged companies that have demonstrated the capability to grow through drilling. We will continue to concentrate on areas where we have competitive advantages such as the Giddings and Golden Trend Fields. We intend to increase our asset base and financial strength through continued acquisition and development of strategic leasehold blocks where we can utilize our geological and engineering strength to deliver attractive financial results.

We emphasize to all of our current and prospective shareholders that we are dedicated to creating consistent and sustained growth in shareholder value. With management owning more than 50% of the outstanding common shares, the financial interests of management and shareholders are truly aligned.

We are grateful to our dedicated employees for their hard work and strong performance during a challenging year. We also wish to thank our directors for their leadership and counsel and our shareholders for their continued confidence. We encourage you to share our enthusiasm for Chesapeake's future.

Aubrey K. McClendon  
*Chairman and Chief Executive Officer*

Tom L. Ward  
*President and Chief Operating Officer*