LETTER TO SHAREHOLDERS

Through your investment in Chesapeake Energy Corporation, you have expressed confidence in Chesapeake's management and our strategy for continuing the growth of the company's reserves, production, cash flow, and earnings. More importantly, we understand that you expect your investment with us to increase in value. Therefore, we are pleased to report that in fiscal 1995, Chesapeake generated a 563% increase in shareholder value – the highest among all companies in the independent energy sector. This was achieved despite a 20% decline in natural gas equivalent prices during the fiscal year.

A key feature distinguishing Chesapeake from its peers has been its ability to produce superior returns to shareholders during periods of flat to lower commodity prices. We have built Chesapeake not just to survive these periods, but to grow and prosper in adverse environments. Our goal has been to create a new model for success as an independent energy producer by building on Chesapeake's competitive advantages described below.

Chesapeake's competitive advantages include:

- Growth through the drillbit business strategy;
- Large inventory of future drilling opportunities;
- Advanced technological expertise in focused operating areas;
- Superior operating margin from effective cost control, and;
- Close alignment of shareholder and management interests.

Before explaining why we believe these competitive advantages can continue to generate meaningful returns to our shareholders, we would like to highlight our operating and financial results for fiscal 1995.

1995's Achievements

During the year, Chesapeake:

- Increased oil and natural gas production 215% to 32 Bcfe.
- Increased total revenues 126% to $67.3 million.
- Increased earnings 200% to $11.7 million and earnings per share 161% to $0.94.
- Increased operating cash flow 198% to $45.1 million.
- Reduced operating costs (DD&A, lease operating expenses, production taxes, and G&A) 30% to $1.04 per Mcfe.

- Increased capital resources through a $90 million senior note offering and expanded bank credit facilities.

COMPETITIVE ADVANTAGES

To succeed in any industry, a company must have certain core competencies which provide distinct competitive advantages. This is especially true in the independent energy sector where more than 200 major and independent public companies compete to find, develop, and produce oil and natural gas reserves. We believe Chesapeake's five competitive advantages help explain how the company has thrived during this challenging period in the energy industry.

GROWTH THROUGH THE DRILLBIT

We have chosen to build Chesapeake through our expertise with the drill bit rather than by acquiring other companies' producing properties. We believe this strategy makes Chesapeake fundamentally different and stronger than most independent energy companies for three reasons.

First, this strategy enables Chesapeake to capture more upside potential from drilling new wells. In the company's project areas, new wells can develop reserves with a value of up to five times the cost of drilling such wells. We accomplish this result by integrating enhanced seismic information with our drilling and completion expertise to develop new reservoirs. Our expertise with new exploration technologies greatly reduces geological risk while earning attractive returns even with today's low commodity prices.

Secondly, because most major oil and natural gas producers have significantly reduced domestic exploration efforts and many independent producers have focused on acquiring producing properties, there is less competition for good exploration ideas. With less competition, Chesapeake has a greater opportunity to leverage its exploration expertise into new areas that have the potential to significantly increase the company's value.

The third reason for Chesapeake's growth through the drillbit strategy is the efficiency created from owning new wells. Just as in operating a new car or factory, operating a newly drilled well is less expensive than operating an older well. Consequently, the company's production and administrative costs per unit of production are the lowest among its peers. Chesapeake therefore has more cash flow available per unit of production to reinvest in its drilling program, providing funding to continue growing the company's oil and natural gas reserves.

The success of this growth through the drillbit strategy is most evident in Chesapeake's oil and natural gas production growth. In the fourth quarter of fiscal 1993, Chesapeake's first full quarter as a public company, the company produced 1.1 Bcfe. By the fourth quarter of fiscal 1995, just two years later, Chesapeake's production increased to 11.9 Bcfe, an increase of almost 1,000%. The company's creativity in identifying attractive geological opportunities, its technological expertise, and its financial resources have enabled Chesapeake, at the end of fiscal 1995 to be the third most active driller onshore in the U.S., ranking behind two much larger companies, Amoco and Union Pacific Resources.

Also at the end of fiscal 1995, Chesapeake ranked first in average depth drilled per well (almost 15,000 feet). By drilling deeper into less extensively explored reservoirs, Chesapeake has a greater possibility of discovering large amounts of previously undiscovered or undeveloped oil and natural gas reserves. These prolific deposits of hydrocarbons are now within the company's reach due to technological advances in seismic and drilling and completion techniques.

THREE-YEAR INVENTORY OF DRILLSITES

A leading indicator of an energy company's potential for future success is the size and quality of its inventory of future drilling projects. Chesapeake's three-year inventory of undrilled locations is our second competitive advantage and provides a strong foundation for our continued reserve and production growth.

The greatest challenge facing all energy producers is the need to replace the oil and natural gas reserves that deplete through daily oil and natural gas production. Similarly, the greatest challenge facing energy investors is the need to identify companies that can continue to grow their reserves and production. Rather than requiring an investor to speculate as to how Chesapeake might replace its depleting reserves with unspecified drilling or future property acquisitions, we have indentified 500 future drillsites on Chesapeake's existing leasehold.

This inventory consists of undrilled locations in the Navasota River, Independence, Knox, Masters Creek, Sholem Alechem, and Arkoma Jackfork project areas. We believe these future drilling opportunities have the potential to more than double Chesapeake's current reserves of oil and natural gas. The common theme linking these projects is Chesapeake's geological focus on unconventional reservoirs. The company has developed all of these projects during the past two years and is now working on several new project areas that have the potential to produce new discoveries in fiscal 1997 and beyond.

TECHNOLOGICAL LEADERSHIP

The increasing rate of technological change in such areas as horizontal drilling, 3-dimensional seismic, and deep fracture stimulation have enabled technically sophisticated companies such as Chesapeake to identify and develop new oil and natural gas reserves more profitably than at any time during the past 20 years. Although Chesapeake has distinguished itself in each of these new technologies, Chesapeake's leadership in horizontal drilling is particularly important. During fiscal 1995, Chesapeake drilled 61 horizontal wells and has drilled 230 horizontal wells since 1990. The company's expertise in horizontal drilling provides lower costs per foot of horizontal wellbore drilled and the potential for recovery of more reserves per dollar invested, both of which result in lower finding costs and higher operating margins.

The talent of Chesapeake's landmen, geologists, and engineers, the company's strong relationships with the vendors who design and manufacture horizontal equipment, and our willingness to experiment with new ideas have enabled Chesapeake to drill increasingly deeper horizontal wells and thereby expand the boundaries of our fields. For example, in just the past year, significant improvements in measurement-while-drilling and logging-while drilling tools, downhole motors, and drillbit technology have contributed to Chesapeake's extension of the downdip limit in Giddings from 13,000 feet to almost 15,000 feet.

The continued extension of this limit is important because as horizontal drilling technology improves, the number of prospective drillsites on Chesapeake's 350,000 gross acre leasehold inventory in Texas and Louisiana continues to increase. Specifically, for every 1,000 feet deeper the company can drill, up to 50 additional drill sites become prospective. Chesapeake's deeper drilling expertise should also enable the company to extend its downdip Giddings success into the potentially prolific Leesville and Masters Creek areas of Louisiana.

Chesapeake has also helped advance the technology of drilling multiple horizontal laterals from a single vertical wellbore. Drilling two or more horizontal laterals enables Chesapeake to develop its reserves by drilling fewer wells and thereby more efficiently using the company's capital. In the Independence area of the Giddings Field, Chesapeake is drilling its first quadrilateral well. This well has been designed to simultaneously produce reserves from both the Austin Chalk and Georgetown formations by drilling four horizontal laterals from one vertical wellbore. We anticipate a cost savings of 50% compared to drilling four single lateral horizontal wells.

SUPERIOR OPERATING MARGIN

Chesapeake's fourth competitive advantage is our industry-leading operating margin. This margin is defined on a per-unit-of-production basis as oil and natural gas sales revenues minus operating costs (defined as lease operating expenses, production taxes, general and administrative expenses, and oil and gas depreciation, depletion, and amortization expenses). The key to creating shareholder value in the energy industry is the ability to generate high levels of cash flow that can be reinvested in a profitable search for new reserves.

Chesapeake maximizes its cash flow per unit of production by increasing its top-line revenues through production growth while carefully managing bottom-line costs. We have developed this industry-leading cost structure by:

- Utilizing horizontal drilling technology to reduce the per unit cost of finding and producing the company's oil and natural gas reserves;
- Concentrating the company's drilling in areas which provide the critical mass necessary to spread operating and overhead costs over a large number of wells;

- Operating 86% of the company's production, thereby allowing our employees to implement the most cost-effective and technologically advanced drilling, completing, and operating procedures, and;
- Maintaining a flat organizational structure which allows Chesapeake to evaluate and quickly respond to attractive opportunities.

Because we believe oil and natural gas prices are likely to remain flat in the near term, the most profitable Mcf of gas or barrel of oil that can be produced is the one produced today. This is because long-lived reserves, burdened by future operating, financing, and administrative costs and adversely effected by the time value of money and the risk of future mechanical or reservoir problems, are less valuable than reserves that can be produced more quickly. As a result, reserves produced sooner rather than later have higher operating margins and are more likely to create shareholder value than those reserves produced in the future.

Chesapeake attempts to develop large per-well oil and natural gas reserves with an average life of 5-6 years, shorter than the industry average of 8-10 years. The combination of accelerating the production of the company's reserves, generating high cash flows from the production, and then successfully reinvesting the cash flows into a technologically advanced exploration program can provide Chesapeake's shareholders with increasing value, even during periods of low oil and natural gas prices.

MANAGEMENT'S LARGE EQUITY STAKE

Chesapeake's fifth competitive advantage is management's ownership of approximately 50% of Chesapeake's equity, the highest in our peer group and among the highest of all NYSE-listed companies. This large ownership has created a culture of entrepreneurship in the company that results in more creative and productive employees. Furthermore, it closely aligns the interests of management and shareholders.

The daily decisions involved in managing Chesapeake's active and technically sophisticated drilling program are made quickly and implemented by employees who have direct lines of communication to management and have a significant stake in the outcome of those decisions. This flat organizational structure combined with our motivated work teams helps Chesapeake outmaneuver its competitors.

LOOKING FORWARD

Chesapeake's exploration strategy has always been based on three core beliefs:

- Large amounts of oil and natural gas reserves remain in unconventional reservoirs in the U.S.;
- Higher returns and value can be created by drilling new wells, and;

- Advances in technology will enable Chesapeake to continue lowering the cost of finding and producing oil and natural gas.

Chesapeake has grown during the past six years from five employees and 50,000 in assets to an industry leader with 200 employees and an enterprise value of $500 million. This success underscores the strengths of the company's strategy, its people, its assets, and its ability to utilize new technologies to discover and develop oil and natural gas reserves. Despite a cautious view that characterizes our industry, we are optimistic that Chesapeake can provide further increases in shareholder value through the company's competitive advantages, core beliefs, and exploration successes. We look forward to reporting further progress as we continue building Chesapeake into what we believe can be the premier independent energy producer in the U.S.

Aubrey K. McClendon
Chairman of the Board and Chief Executive Officer

Tom L. Ward
President and Chief Operating Officer

October 1, 1995