



Dear Fellow Shareholders:

Chesapeake's performance in 1997 contrasted sharply with the previous three years when the company led the independent energy sector in production, earnings and cash flow growth and the creation of shareholder value. As owners of approximately 35 million shares of common stock, Chesapeake's management, directors, and employees suffered the greatest impact from the company's disappointing performance in 1997.

Determined to prove that 1997 was an aberration, we have taken significant steps over the past several months to improve the company's fortunes in 1998 and beyond. We are pleased to report that our repositioning effort is well underway.

Rising to the Challenge

Chesapeake's growth strategy for 1998 and beyond is designed to enhance shareholder value by creating a stronger, more balanced company. We intend to accomplish our goals by significantly strengthening Chesapeake's reserve base and increasing production levels through the following complementary objectives:

- Acquire and exploit long-lived natural gas assets in the Mid-Continent area;
- Continue developing high cash flow Austin Chalk properties in Texas and Louisiana, but at a significantly reduced pace;
- Develop a substantial Canadian natural gas asset base;
- Deliver high-impact upside through our 3-D seismic exploration programs;
- Act opportunistically as commodity price volatility creates further acquisition and joint venture possibilities.

Mid-Continent Acquisition Program

Before drilling costs rapidly increased in 1997, our strategy of focusing exclusively on growth through the drillbit had the potential to generate the highest growth rates. However, in today's environment of lower oil prices, higher drilling costs and increasing financial and technological pressure on smaller public and private companies, acquisition opportunities provide an excellent complement to our traditional drill bit growth strategy. To capitalize on these opportunities, the company commenced an aggressive acquisition program beginning in late 1997, principally in the Mid-Continent region of the U.S., consisting of Oklahoma, Kansas, and the Texas Panhandle.

The third largest gas basin in the U.S., the Mid-Continent is noted for its long-lived reserves, multiple pay zones, high concentration of natural gas, and attractive exploration upside. It is also an area where Chesapeake has significant geological knowledge, having drilled over 300 producing wells since 1989. Because of these favorable characteristics, Chesapeake has focused the majority of its recent acquisitions in the Mid-Continent, where 72% of our estimated 1,138 bcfe of gas reserves are now located. The table below summarizes our acquisition activity during the past seven months:

Transaction Name	Area	Date Announced	Bcfe Acquired	Cost in \$MM
AnSon	Mid-Continent	10/97	26	\$ 36
DLB*	Mid-Continent	10/97	110	122
Hugoton	Mid-Continent	11/97	246	306
EnerVest	Mid-Continent	1/98	43	38
Ranger	Canada	1/98	54	28
Oxy	Mid-Continent	3/98	109	100
Gothic*	Mid-Continent	3/98	52	20
Sunoma*	Canada	3/98	40	33
Miscellaneous*	Mid-Continent	3/98	36	34
Acquisition Totals			716	\$ 717

* Pending acquisitions

The first two acquisitions, announced in October, included the Mid-Continent assets of DLB Oil & Gas, Inc., a publicly traded Oklahoma City company and privately held AnSon Production Corporation. These companies contributed estimated proved oil and gas reserves of 136 bcfe, significant probable and possible reserves, an extensive 3-D seismic database, and profitable gas gathering and marketing operations, at a total cost of \$158 million in cash and common stock. The AnSon acquisition was completed in December and the DLB merger is scheduled to close in late April 1998.

Chesapeake's largest acquisition to date, announced last November and closed in March 1998, was Hugoton Energy Corporation. This Wichita, Kansas public company further enhanced Chesapeake's reserve base by adding 246 bcfe of estimated proved reserves in the Mid-Continent, primarily in the prolific Hugoton Gas Field of southwest Kansas and the Anadarko Basin Shelf in northwest Oklahoma. The Hugoton acquisition also contributed additional properties to Chesapeake's Williston Basin producing area in North Dakota and Montana. In the Hugoton transaction, Chesapeake issued 25.8 million shares of common stock and assumed \$120 million of outstanding debt.

In January 1998, Chesapeake announced its fourth Mid-Continent asset acquisition with a \$38 million, 43 bcfe purchase of the western Oklahoma properties of EnerVest Management Company, L.L.C., a private company headquartered in Houston, Texas. These assets, located

near the AnSon properties, added important critical mass to the company's Anadarko Basin core area, the high-potential, prolific gas producing region of western Oklahoma and the Texas Panhandle.

Another acquisition, which complements the Texas Panhandle properties acquired from Hugoton, was the March 1998 \$105 million purchase of MC Panhandle Corp., a wholly-owned subsidiary of Occidental Petroleum Corporation. These properties provided 109 bcfe of estimated proved reserves that produce from two shallow formations, the Red Cave at 1,350 feet and the Brown Dolomite at 3,700 feet. Chesapeake believes significant upside potential exists through out planned increased density drilling program for the shallower formations and by utilizing 3-D seismic to identify deeper reserves at depths to 15,000 feet.

The latest example of Chesapeake's opportunistic deal-making strategy is the innovative transaction announced last month with Gothic Energy Corporation, a public company located in Tulsa, Oklahoma. Gothic's assets in the Mid-Continent were largely built through the January 1998 acquisition of most of Amoco's natural gas assets in Oklahoma.

In the Gothic transaction, Chesapeake agreed to acquire 50% of Gothic's 45 bcfe of estimated proved developed natural gas reserves in the Arkoma Basin of eastern Oklahoma for \$20 million. Additionally, Chesapeake will invest \$50 million in Gothic through a preferred stock offering. As part of the investment, Chesapeake will also acquire 50% of Gothic's 60 bcfe of estimated proved undeveloped reserves in the Arkoma and Anadarko Basins and will enter into a five-year agreement giving Chesapeake the right to participate in Gothic's future drilling and acquisition efforts for a 50% working interest. Chesapeake also will obtain warrants to acquire 15% of Gothic's currently outstanding common stock during the next ten years for \$0.01 per share. The Gothic transaction is scheduled to close in late April 1998. We believe this agreement and our 1997 Canadian transactions with Pan East and Ranger Oil, plus our profitable capital investment in Bayard Drilling Technologies, demonstrate management's ability to identify and develop attractive investment opportunities.

Together our Mid-Continent acquisitions have added 620 bcfe of estimated proved reserves (150% of the entire reserves previously owned by the company), increased our natural gas reserves to 81% of total reserves, lengthened our reserve life to 8.5 years, strengthened the proved developed component of our reserve base to 65%, and significantly reduced the risk profile of our company. These acquisitions also increased our backlog of drilling opportunities to approximately 865 potential drillsites, located in prolific natural gas producing areas. Chesapeake continues to evaluate additional Mid-Continent opportunities and believes substantial economic benefits are available to the company from further Mid-Continent consolidation.

Continuing Austin Chalk Development

Chesapeake's second growth objective is to continue developing its Austin Chalk properties in Texas and Louisiana, but at a significantly slower pace than in the past. When drilled successfully, an Austin Chalk well can deliver high levels of production and accelerated cash flows, creating some very attractive rates of return. However, our Louisiana Austin Chalk results outside of the Masters Creek area have not met our expectations and therefore we have materially reduced our Austin Chalk capital expenditure program in 1998 from previous levels.

Pro forma for our Mid-Continent and Canadian acquisitions, the Austin Chalk now accounts for only 18% of our estimated proved reserves and will likely decline to 10-12% in 1999. Our 1998 Austin Chalk drilling will be concentrated in the Masters Creek area in Louisiana and the Independence area in Texas.

Canadian Growth Opportunities

Another objective of our growth strategy is developing a significant Canadian natural gas asset base, on the order of 15-20% of our total estimated proved reserves. We believe investment in the Canadian natural gas industry provides opportunities to explore for high-potential gas reserves in the relatively underdrilled Western Canadian Sedimentary Basin and to participate in the anticipated improvement of Canadian gas prices associated with new pipeline projects.

Our three recent Canadian investments have provided us with a strategic beachhead in Canada and account for 8% of our pro forma estimated proved reserves. Our first Canadian investment was the acquisition of 19.9% of the common stock of Pan East Petroleum Corp., a publicly-traded oil and gas producer with operations in west central Alberta and northeast British Columbia. In these areas, Pan East and Chesapeake formed a two-year exploration joint venture to more aggressively develop Pan East's asset base.

Our second Canadian alliance is with Ranger Oil Limited, a NYSE-listed Canadian exploration and production independent. In this transaction, Chesapeake invested \$48 million to acquire 53 bcf of estimated proved natural gas reserves and entered into a 40/60 joint venture agreement to further develop the high potential Jean Marie formation in the 3.2 million acre Helmet area of northeast British Columbia. Early results from our 1997 winter drilling program with both Pan East and Ranger look favorable.

In our most recent Canadian transaction, Chesapeake agreed to purchase for \$33 million the Helmet area properties of Sunoma Energy Corporation, a privately held Calgary-based natural gas producer. The properties acquired from Sunoma are located near Ranger's Helmet properties and complement our strategy of concentrating Chesapeake's Canadian gas assets in this high potential area. The company is attracted to the Helmet area because of the estimated three trillion cubic feet of natural gas reserves located in the Jean Marie formation in Helmet. Furthermore, we anticipate this area will be one of the largest beneficiaries of increases in

natural gas prices when additional Canadian gas export capacity is completed in late 1998 and in 1999.

Our Canadian investments, which combine Chesapeake's efforts to identify opportunistic reserve additions, develop creative financial structures, and utilize the company's technological expertise are prime examples of the innovative manner in which we plan to deliver additional value to our shareholders.

High-Impact Exploration Upside

Chesapeake's fourth growth objective is to deliver high-impact exploration upside through large and technologically challenging 3-D seismic projects. Later this year, Chesapeake intends to drill a number of 3-D projects conducted during 1997 and early 1998. They include the company's Tuscaloosa Trend project area near Baton Rouge, Louisiana; the Peach Creek prospect in the Wharton County area of southeast Texas; and the continued development of the Strawn formation in the Lovington, New Mexico area.

In the Tuscaloosa Trend, Chesapeake's goal is to emulate the drilling success of the nation's premier Tuscaloosa driller, Amoco Production Company. During the past four years, Amoco successfully completed 17 of 18 Tuscaloosa wells and discovered a reported 400 bcfe through utilization of 3-D seismic.

Chesapeake's two 3-D seismic Tuscaloosa projects cover 90,000 acres in the Morganza and Irene fields, where average estimated reserves using 2-D seismic have averaged 12-15 bcfe per well. Our initial 3-D drilling in both fields should begin by mid-year and the company's geoscientists have generated approximately 25 drillable prospects from these 3-D surveys. We have four Tuscaloosa wells planned in our 1998 drilling program.

We are also enthusiastic about the upside potential of our 30,000 acres of leasehold in the Peach Creek area of Wharton County, Texas. In this area, Chesapeake is engaged in an 85,000 acre 3-D seismic survey with Coastal Corporation, Seagull Energy Corporation, TransTexas Gas Corporation, and Unocal Corporation, focusing on imaging large natural gas traps in the Frio, Yegua, and the especially high potential Deep Wilcox formation.

Since 1996, Chesapeake has successfully drilled 17 of 21 wells in the Lovington area, located within the Permian Basin in southeast New Mexico. In this area, the company has utilized 3-D seismic to find algal mound buildups estimated to contain an average of 250,000 barrels of oil at an average per well cost of \$1 million. In 1998, the company plans to drill 10-15 additional wells and to increase the size of its 3-D coverage.

Future Acquisitions and Joint Venture Opportunities

During the remainder of 1998 and in 1999, Chesapeake will remain alert for complementary Mid-Continent and Western Canadian acquisitions and joint venture opportunities created by commodity price uncertainty; financial or technological limitations experienced by other companies, and the ability to increase ownership in the company's wellbores and fields. As a greater portion of Chesapeake's operations become focused in these two regions, we anticipate that the incremental cost of operating and developing new properties will be reduced through economies of scale.

Management Outlook

Although 1997 was a year of great disappointment for Chesapeake's shareholders and employees, it was also a year of tremendous accomplishment. During 1997, we substantially modified the company's strategy and significantly strengthened and diversified our asset base. Historically, the oil and gas industry has been subject to frequent and sometimes dramatic change. Management of an oil and gas company must be able to quickly modify its strategy to capture the benefits created by industry change and uncertainty. In the past nine months, we have transformed Chesapeake into a more balanced and diversified company with a lower risk profile but with significant growth potential.

Chesapeake is defined today by balance: balance between drillbit growth and acquisitions, balance between Mid-Continent development projects and exploration upside, balance between long and short reserve life properties, and balance between drilling capital expenditures and operating cash flow. We believe the recent completion of our \$700 million senior notes and preferred stock offerings are evidence that Chesapeake's turnaround is well underway.

We are hopeful our present and prospective shareholders will appreciate the company's ability to respond quickly and creatively to adversity; rise to the challenges before us and restore Chesapeake as an industry leader in creating shareholder value.

Aubrey K. McClendon

Tom L. Ward

April 20, 1998