Letter to Shareholders

What a difference a year makes! Rarely does the outlook for an industry change so dramatically in the course of a year. Early in 1999, oil and natural gas prices collapsed to near 20-year lows of $10 per barrel and $1.50 per mcf. Observers such as The Economist magazine dramatically proclaimed that the world was drowning in what soon would be $5 oil. They also predicted that all commodity prices, particularly oil and gas, were likely to stay low for the foreseeable future. Looking back, that prediction in March 1999 in fact marked the bottom of the pricing cycle. Energy prices are today near 20-year highs of $30 per barrel and almost $3 per mcf.

The dramatic pricing swings of the past year highlight oil and natural gas as the most volatile commodities in the world. As a consequence, investing in oil and gas companies is not for the faint of heart and requires a willingness to ride out challenging times. However, America's growing demand for energy, particularly clean-burning natural gas, has set the stage for what is likely to be a sustained period of strong energy pricing and substantial rewards for Chesapeake's shareholders.

Excellent results in 1999

Despite a very tough operating environment in 12 of the past 18 months, Chesapeake has continued to overcome challenges and achieve our goal of creating value-added growth for our investors. Listed below are a few of Chesapeake's accomplishments in 1999 compared to 1998's results:

- net income of $33 million, compared to a loss of $934 million
- operating cash flow of $138 million, an increase of 20%
- ebitda (cash flow plus interest expense) of $219 million, up 20%
- proved oil and gas reserves of 1,206 bcfe, an increase of 11 %
- oil and gas production of 134 bcfe, up 3% even after property sales
- reserve replacement of 186% at a cost of only $0.65 per mcfe

In achieving these results, we stayed true to Chesapeake's single-minded focus on developing onshore natural gas reserves, generated a terrific year in replacing reserves with the drillbit, and delivered the highest return to shareholders in our peer group with a stock price increase of 153%.

Balance sheet resiliency - the key to surviving tough times

While we could not have predicted the strength or timing of the current oil and gas price recovery, we did correctly anticipate that industry supply and demand fundamentals would improve and, in time, cause oil and gas prices to increase. Accordingly, we managed our way through the challenges of late 1998 and the first half of 1999 by focusing on strategically exploiting our asset base while still maintaining balance sheet liquidity. Our balance sheet, though more leveraged than we would prefer, proved to be very resilient during these tough times. Many other companies with less flexibility were forced by their creditors to sell properties at the bottom of the pricing cycle.

We built Chesapeake's balance sheet to withstand the downturns that periodically occur in our industry. Other than a small working capital facility, none of Chesapeake's debt is owed to banks. Instead, our capital providers have been high-yield mutual funds and insurance companies that do not require repayment for years to come (2004 is our earliest maturity, 2012 the latest). With their understanding of the ups and downs of the energy industry, these capital providers do not require collateral or other rigid lending provisions imposed by traditional lenders. This flexibility enabled us to carry on through last year's turbulent cycle so our shareholders could enjoy this year's resurgent oil and gas prices.

Chesapeake's low costs lead the industry

In addition to a resilient balance sheet and a strategically focused emphasis on natural gas, we also enjoy an industry-leading cost structure. This attractive cost structure reflects the high quality of our properties and the strong work ethic of our employees and hence, our motto - Energy At Work.

As a young company in a rapidly aging industry (50% of the industry's technical talent will reach retirement age in the next 12 years), we believe we can stay a step ahead of the competition. And with all of Chesapeake's employees owning stock (management and directors together own 25% of the total shares), we are motivated to work especially hard to create shareholder value. In addition, our wells' average productivity is 50% higher than the industry's average and their close proximity to a well-developed service infrastructure provides for lower current and future maintenance costs.

Growth capital used to build Chesapeake's premier natural gas franchise

The debt we incurred and assets we acquired during the past 10 years have enabled us to build Chesapeake into one of the largest natural gas franchises in the U.S. The providers of Chesapeake's growth capital (ultimately the individual investors in the mutual funds, 401-K plans, and insurance policies who invest in high yield debt) entrusted their investment to us for extended periods so that we would have time to execute our strategy and create value for investors.

And create value we have. By our calculation, Chesapeake is one of only three public U.S. oil and gas producers founded in the past 10 years that is now valued at over $1 billion. From a $50,000 investment in 1989, we have built Chesapeake into one of the 15 largest gas producers in the U.S. and among the four largest gas producers in the Mid-Continent.

Looking ahead

As we look forward to 2000 and beyond, we are excited about several developing trends. First, we have reestablished Chesapeake's long-term growth potential. As we think about 2004, the year of our first senior note maturity, we believe we can increase Chesapeake's reserves, production, cash flow, ebitda and net income by 50% from 1999's record results. This will require average growth of 8% per year, a level that we hope proves conservative during the next five years.

Second, we are pleased with the accelerating positive trends in natural gas supply and demand. Most importantly, the rapidly increasing demand for electricity generated from burning natural gas is overwhelming the negative impact of yet another record-breaking warm winter.

Why the strength in natural gas prices in the face of four warm winters in a row? The answer is in the country's increasingly fragile natural gas supply base. It now appears that in years where the industry is forced to live within its internally generated cash flows (such as 1998 and 1999), supply actually decreases 1-4%. By contrast, in years where inflows of outside capital are available to the industry (although there's not much to be had these days after technology companies have grabbed their share), drilling efficiency and prospect quality decline to levels where the industry's production remains flat or increases only a little. In addition, the increasingly tight supply/demand situation in the U.S. will likely be exacerbated in the years ahead as our country reduces its consumption of environmentally unfriendly fuels such as oil, coal and uranium in favor of clean-burning natural gas.

So in our view, something will have to give in the next few years. Either the nation's insatiable appetite for energy will have to stop growing or natural gas prices will have to increase further, thereby providing enough capital for the gas industry to increase production to meet surging demand.

21st Century - the age of natural gas

As this decade unfolds, we believe investors will increasingly envision this century as the age of natural gas. Just as great wealth was created during the 20th century in the age of oil and in the 19th century in the age of coal, we believe investors will profit from embracing the tremendous potential of the natural gas industry.

We are proud of the company's accomplishments in 1999 and look forward to many rewarding years for our shareholders in the decade ahead.

Best regards,

Aubrey K. McClendon

Tom L. Ward

March 15, 2000
