



## **Letter to Shareholders**

The cover to this year's Annual Report makes clear that Chesapeake celebrated its tenth anniversary as a public company in 2002. Despite experiencing extremely volatile oil and natural gas prices during the past ten years, Chesapeake has grown from little more than a start-up to become the eighth largest independent natural gas producer in the U.S. Along the way, Chesapeake has delivered a total return to shareholders of 482%, a Compounded Annual Growth Rate (CAGR) of 20%.

We are especially proud that many of Chesapeake's operational results in 2002 were its best ever. The company ended 2002 with 2.2 trillion cubic feet of gas equivalent (tcf) proved reserves and produced 181.5 billion cubic feet of gas equivalent (bcfe) during the year. Both of these were records and represented increases of 24% and 12%, respectively, over last year's results.

And, we are already off to a great start in 2003. During the first quarter of 2003, Chesapeake purchased \$830 million of attractively priced, high-quality Mid-Continent gas reserves from ONEOK, Inc., El Paso Corporation and Vintage Petroleum, Inc. These purchases ensure that in 2003 Chesapeake will once again reach record levels of proved reserves and production. We are currently estimating that the company's year end 2003 proved reserves will exceed 2.75 tcf, and 2003 production levels should exceed 230 bcfe, both increases of approximately 25% over 2002's results.

### **Chesapeake's Business Strategy**

The driver of Chesapeake's accomplishments during the past decade has been the company's unique focus on building one of the nation's largest onshore natural gas asset bases through balanced programs of deep gas exploration and opportunistic producing property acquisitions. The successful execution of this balanced business strategy has enabled Chesapeake to build unique economies of scale, an unrivaled backlog of drilling opportunities and the most accomplished Mid-Continent team of land, geoscience, engineering and operations personnel.

Because natural gas has become the fuel of choice to meet steadily increasing energy demand in the U.S., Chesapeake's focus on natural gas should provide substantial growth and financial return opportunities for its shareholders in the years ahead. With an undeveloped prospect inventory of 2,000 drillsites and further Mid-Continent consolidation opportunities likely in the coming years, our goal is to continue increasing Chesapeake's proved reserves, natural gas

production, cash flow from operations and earnings per share by at least 15% per year on average. We also plan to continue improving Chesapeake's balance sheet and believe that further credit rating agency upgrades are likely as we continue executing the company's business strategy.

### **Chesapeake's Mid-Continent Focus**

This strategy includes staying focused on the Mid-Continent, which is the nation's third-largest gas supply region and the location of 90% of Chesapeake's assets. Geographically, this area consists of Oklahoma, western Arkansas, the Texas Panhandle and southwest Kansas. In this region, Chesapeake is the largest natural gas producer (with a gas production market share greater than the combined share of the next two largest producers - BP and Apache), the most active driller (by a 4:1 margin over the second most active driller) and the most aggressive consolidator of under-exploited producing assets.

We have a number of reasons for concentrating in this region. The Mid-Continent is characterized by long lived natural gas reserves that have predictable decline curves, multiple drilling targets that significantly reduce the risk of drilling dry holes, strong natural gas prices, lower service costs than in more competitive or remote basins and a favorable regulatory environment that allows for shorter prospect cycle times with virtually no federal land ownership issues. In addition, the location of our headquarters in Oklahoma City provides competitive advantages over companies that direct their Mid-Continent activities from other more distant locations.

### **Chesapeake's Growth Through the Drillbit**

Chesapeake has increased its production in each of the past ten years, a remarkable achievement in an industry that has frequently experienced decreasing production during this period. Much of Chesapeake's growth has been created by the success of its internally generated drilling program. Since the company's inception in 1989, Chesapeake has built substantial operational expertise by drilling over 1,550 wells in some of the most challenging geological and operating environments in the U.S.

Today, Chesapeake is the third most active driller in the U.S. and the most active driller in the Mid-Continent. We plan to maintain Chesapeake's current level of drilling (32-38 rigs drilling on Chesapeake-operated prospects and 35-40 additional rigs drilling on non-operated prospects) throughout 2003. This level of drilling should result in continuing sequential quarterly increases in the company's production during 2003.

One of Chesapeake's greatest strengths is its drilling capability in the deep and complex geological structures of the Mid-Continent, to depths beyond the technological reach of many of the company's competitors. Chesapeake is presently drilling two of the three deepest onshore wells in the U.S., and historically has drilled, on average, the deepest wells in the country. We target deep and challenging gas reservoirs in Oklahoma's Arkoma and Anadarko Basins

because we believe that a tremendous amount of gas remains to be discovered in these basins at depths below 15,000 feet - depths at which Chesapeake's geological and operations teams have industry-leading knowledge and experience.

In addition, the company's large 3-D seismic database provides important subsurface information and substantially reduces the geological risk associated with exploring for deep gas reserves 3-5 miles below the earth's surface. Because of our aggressive land acquisition strategies and Oklahoma's favorable regulatory environment, Chesapeake has been able to accumulate an onshore leasehold position of more than 2.2 million net acres. On this vast land inventory, Chesapeake's technical teams have identified more than five years of future drilling opportunities at our current rate of drilling. Chesapeake is unique: a prospect-rich company in an increasingly prospect-poor industry.

### **Chesapeake's Growth Through Acquisitions**

Since January 1998, Chesapeake has complemented its drillbit success by completing over \$2.7 billion of targeted, high-quality, Mid-Continent corporate and producing property acquisitions. By focusing on gas assets with low operating costs in areas with substantial remaining developmental and exploratory drilling upside, Chesapeake's acquisition efforts have been a key factor in enhancing value creation for its shareholders during the past five years.

The hallmark of Chesapeake's acquisition program is its focus on smaller public and private independent producers and on small to mid-sized producing property packages that are being sold by larger, less-focused companies. By avoiding larger transactions, we are less likely to pay for upside and can more easily integrate the acquisitions without disrupting the normal flow of our work. We also have a team of acquisition experts that focuses on purchasing smaller working and mineral interest owners in the company's existing wells. Because Chesapeake operates 5,700 wells and has more than 33,000 co-owners, we find numerous opportunities each year to consolidate ownership in the company's wells at very attractive acquisition costs.

Given that further consolidation among public companies in our industry is likely and that smaller private companies will continue experiencing more challenging operational and financial environments, Chesapeake expects to continue making value-added Mid-Continent gas acquisitions in the years ahead. One of the keys to success in this industry is the ability to generate balanced growth. Sometimes it is more advantageous to drill, and sometimes it is better to acquire. Chesapeake's historical performance demonstrates that its excellence in both areas is a key competitive advantage.

### **Chesapeake's History**

As Chesapeake's co-founders, we would like to put into historical context the company's achievements of the past ten years. Chesapeake's roots go back to 1983 when we were 24-year-old landmen competing for leases in a hot play near the Oklahoma City airport. We were both native Oklahomans with third generation roots who had recently left the companies we

were working for to go out on our own. From 1983 to 1989, we operated a small 50/50 partnership on a handshake, generating oil and gas prospects for sale to the industry and participating as non-operators in the drilling of wells by others.

Around the time of our 30th birthdays in 1989, we decided to start operating wells and incorporated Chesapeake with a \$50,000 investment. Our first drilling efforts focused on the Golden Trend and Sholem Alechem fields in southern Oklahoma and on the Giddings field in south Texas. As a result of initial drilling successes in these three fields, the company grew quickly, and in February 1993 Chesapeake completed its IPO at the split-adjusted price of \$1.33 per share. This valued the company at approximately \$70 million and reduced our common stock ownership position to just under 60% from 100%.

After a rocky start in 1993 (the stock declined 65%), Chesapeake began to grow rapidly from 1994 through 1996 through a series of major natural gas discoveries in the Giddings Field in southeast Texas. During this extraordinary three-year period, the company's stock price increased 73-fold from \$0.47 per share to \$34.44 per share, making Chesapeake the #1 performing stock in America. During this time, the company's enterprise value soared from a low of \$35 million in early 1994 to a peak of \$2.7 billion in late 1996. However, because of a failed effort to extend the company's success in the Austin Chalk trend from Texas into Louisiana and a dramatic collapse in oil and natural gas prices, Chesapeake's stock fell during 1997 through early 1999 reaching a low of \$0.63 per share.

Facing the need to redefine Chesapeake's strategy and underpin the company with longer-lived assets and lower-risk drilling opportunities, we decided to return to our roots in Oklahoma as Mid-Continent natural gas producers. We were convinced that supply-constrained U.S. natural gas prices would outperform oil prices in the years ahead and that tremendous opportunities existed in the Mid-Continent for producing property acquisitions and corporate consolidations and for the application of leading-edge, deep gas exploration techniques. The success of Chesapeake's restructuring effort is clearly apparent today by our growth to the nation's eighth-largest independent natural gas producer and in our stock price, which is up over 12-fold from early 1999.

### **Ten Years of Value Creation**

As we close the historical review section of this letter, we want to share with you some of Chesapeake's most notable achievements during its first ten years as a public company. During the ten years from 1993 through 2002, Chesapeake's

- *production increased from 4 bcfe to 181 bcfe, a CAGR of 49%;*
- *proved reserves increased from 137 bcfe to 2,205 bcfe, a CAGR of 34%;*
- *revenues grew from \$18 million to \$738 million, a CAGR of 48%;*
- *shareholders' equity increased from \$31 million to \$908 million, a CAGR of 42% and;*

- *stock price increased from a split-adjusted IPO price of \$1.33 per share to \$1.74, a CAGR of 20%.*

Chesapeake's stock price performance has been the best in the oil and natural gas industry during the past four years and the second best during the past ten years, more than doubling the performance of the DJIA, S&P 500, and the NASDAQ during the past ten years.

### **Looking Forward**

As we reflect on what Chesapeake has accomplished in just its first decade as a public company, we believe the experience we have gained and the financial, operational and technical teams we have built provide the opportunity for even greater returns during the next ten years. The company is certainly off to a great start in the first year of its second decade. In the first quarter of 2003, we have already increased Chesapeake's proved oil and gas reserves and production by 25% through the \$830 million of acquisitions mentioned previously.

Further growth this year will occur as a result of the successful execution of our deep gas drilling programs. In addition, the combination of the strong outlook for natural gas prices and the proven success of our focused strategy, value-added risk management programs, balanced and successful drilling and acquisition programs, high-quality assets, low operating costs and high profit margins should enable Chesapeake to continue generating superior performance for its shareholders in the years ahead.

Best regards,

Aubrey K McClendon  
Chairman and Chief Executive Officer

Tom L. Ward  
President and Chief Operating Officer

March 31, 2003