

Chesapeake



Letter to Shareholders - Second Quarter 2004

Dear Fellow Shareholders:

During the second quarter of 2004, Chesapeake's operational results were once again record-setting, while our financial results were just slightly below the record levels achieved in the first quarter of 2004. In the second quarter, oil and gas production reached a record level of 86.5 billion cubic feet of gas equivalent (bcfe), proved reserves rose to an all-time high of 3.8 trillion cubic feet of natural gas equivalent (tcfe), net income available to common shareholders increased to \$86 million, operating cash flow* reached \$308 million and EBITDA** rose to \$324 million.

Operating and Financial Highlights

Comparing the 2004 second quarter to the 2003 second quarter, we're proud to report that:

- * Oil and natural gas production rose to 86.5 bcfe, up 29%;
- * Oil and gas proved reserves rose to a record level of 3.8 tcfe, up 29%;
- * Total revenue increased to a record \$574 million, up 34%;
- * Operating cash flow climbed to \$308 million, up 36%;
- * Net income available to common shareholders increased to \$86 million, up 13%.

During the 2004 second quarter, Chesapeake produced an average of 951 million cubic feet of gas equivalent (mmcfe) per day, of which 88% was natural gas. The company has now become the fifth largest independent producer of natural gas in the U.S., doubling its daily production in the past three years. For the 2004 third quarter, we are forecasting a 5% sequential increase in production to 1,000 mmcfe per day, with an additional 5% sequential increase to 1,049 mmcfe per day forecasted for the 2004 fourth quarter. For the full year 2005, we are projecting a 12% year-over-year production increase to almost 1,100 mmcfe per day. We believe these growth rates are likely to be among the very best in the industry during this period.

Proved reserves of oil and gas, the company's primary assets, grew at the very impressive rate of 10% since March 31, 2004 (and 29% since June 30, 2003), with the company's production of 86.5 bcfe being replaced with 429 bcfe of new reserves, a reserve replacement rate of nearly 500%. Of this reserve replacement, one third was generated through our drilling operations and two-thirds was attributable to property and corporate acquisitions. In addition to our quarter-ending reserves of 3.8 tcfe, the company added an additional 310 bcfe of proved reserves after the end of the second quarter, bringing Chesapeake's current proved reserves to 4.1 tcfe.

Chesapeake is Now the Nation's Most Active Driller

Chesapeake continues to lead the industry in the search for new reserves of natural gas to meet our country's increasing demand for this very valuable domestically produced, clean-burning fuel. During the quarter, Chesapeake invested approximately \$200 million in drilling new wells and \$100 million in acquiring new 3-D seismic information and new leasehold. The company now owns what it believes to be the largest onshore inventory of leasehold and 3-D seismic in the industry, more than three million and eight million acres, respectively.

To convert these significant non-producing assets to production, cash flow and earnings, we are executing the nation's most focused and active search for natural gas reserves. Chesapeake is presently using approximately 60 company-operated drilling rigs and 60 non-operated rigs to develop our rapidly expanding asset base. In fact, we are now involved in approximately 10% of all U.S. drilling and more than 50% of the drilling in the Mid-Continent region. This unprecedented level of activity provides unique and powerful informational advantages for Chesapeake in both our drilling and acquisition activities.

To strengthen our competitive advantages and to take advantage of the very favorable economics of today's oil and gas industry, the company continues to enhance its intellectual and technological talent base. In the past three years, Chesapeake has more than doubled the size of its technical teams and now has more than 75 geoscientists, 100 engineers and 100 landmen generating new prospects every day from our three million acre leasehold inventory. On this inventory, Chesapeake has identified more than 5,000 drill sites that we believe contain more than four trillion cubic feet of probable and possible natural gas reserves***. Based on today's gas prices of nearly \$6 per thousand cubic feet (mcf), the company's exposure to these probable and possible gas reserves has the potential to substantially increase the company's net asset value during the next five years.

Acquisitions Continue to Strengthen Asset Base

During the second quarter, Chesapeake entered into an agreement to acquire natural gas assets in the Ark-La-Tex region of northern Louisiana through the \$425 million acquisition of Greystone Petroleum LLC. Greystone's major asset was its 16,100 gross acre contiguous leasehold position over the crest of the giant Sligo Field located in Bossier Parish, Louisiana. Discovered in 1938, the Sligo Field has produced more than 1.6 tcf of natural gas from numerous formations located at depths between 4,100 and 9,600 feet and we believe it will be a strong producer for decades to come.

After the quarter's end, Chesapeake announced two additional acquisitions of natural gas assets in the Mid-Continent and South Texas regions. The transactions involved the acquisition of Tulsa-based Bravo Natural Resources, Inc. and the acquisition of substantially all the assets of Houston-based Legend Natural Gas, LP.

Bravo's assets consisted of 20,000 acres located in the Granite Wash-producing Stiles Ranch and Allison Britt fields of the Anadarko Basin. The Granite Wash, and the deeper Cherokee and Atoka Washes, have produced more than 1.2 tcf from 10 major fields in the Anadarko Basin and are currently the subject of intense drilling programs by multiple operators in western Oklahoma and in the Texas Panhandle. Chesapeake now has more than 100,000 acres of potentially prospective leasehold in the prolific Granite Wash play and expects to become the leader in the continued development of this large prospect area.

The producing assets to be acquired from Legend include 18,000 net acres of leasehold that are located in the Zapata County portion of South Texas. The primary zones of production in these fields are various sands of the Middle and Lower Wilcox formations at depths ranging from 7,000 to 13,000 feet. Zapata County is Texas' most prolific natural gas producing county and Chesapeake will now be the

fourth largest gas producer in Zapata County.

Company Increases Common Stock Dividend by 29%

During the quarter, Chesapeake announced that its Board of Directors declared a \$0.045 per share quarterly dividend, an increase of \$0.01 per share, or 29%, from the quarterly dividend paid in the prior quarter.

Management's Outlook

We delivered very strong operational and financial results in the 2004 second quarter that provide further affirmation that Chesapeake continues to execute its successful business strategy with precision. Our strategy focuses on delivering growth through a balance of acquisitions and organic drilling, focusing on natural gas to take advantage of strong long-term supply/demand fundamentals and building dominant regional scale to achieve low operating costs and high returns on capital.

This business strategy has worked very well for our shareholders, generating more than a 1,500% increase in our common stock price during the past five years. We believe Chesapeake's management team can continue successfully executing the company's distinctive business strategy and delivering significant shareholder value in the years ahead.

Best regards,

Aubrey K. McClendon
Chairman and Chief Executive Officer

Tom L. Ward
President and Chief Operating Officer

July 31, 2004

*Operating cash flow represents net cash provided by operating activities before changes in assets and liabilities.

** Ebitda represents net income (loss) before cumulative effect of accounting change, income tax expense (benefit), interest expense, depreciation, depletion and amortization expense.

***The SEC has generally permitted oil and gas companies, in filings made with the SEC, to disclose only proved reserves that a company has demonstrated by actual production or conclusive formation tests to be economically and legally producible under existing economic and operating conditions. We use the terms "probable" and "possible" reserves or other descriptions of volumes of reserves potentially recoverable through additional drilling or recovery techniques that the SEC's guidelines may prohibit us from including in filings with the SEC. These estimates are by their nature more speculative than estimates of proved reserves and accordingly are subject to substantially greater risk of being actually realized by the company.