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Zacks Small-Cap Research

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Chesapeake Financial Shares, Inc. (CPKF-OTCQX)

CPKF: Some Surprises, But a Good Quarter Overall

We have chosen the $31.50 midpoint of the range of values based upon CPKF's 2022 P/E of $30.00 and forward Price/Tangible Book Value of $32.75 as our new valuation.

Current Price (11/19/21)	$30.00
Valuation	**$31.50**

OUTLOOK

CPKF's third quarter net earnings increased $0.4 million, or 11%, year over year to $3.8 million, while 2021's third quarter diluted EPS soared by $0.09, or 13%, to $0.78 from $0.69 posted a year ago. This was well above our estimate, which had called for a $0.6 million decrease in net earnings to $2.8 million and a $0.11 decline in diluted EPS to $0.58. The major reasons for the third quarter's rise versus the prior-year quarter were a $1.6 million gain in net revenues, a $1.15 million decline in the provision for loan losses, and income tax payments that were $0.5 million lower due to a reduced effective tax rate, which were partly offset by a $2.9 million increase in total noninterest expense. We are raising our diluted EPS estimates by $0.20—in 2021 to $3.15 (from $2.95), 32% above 2020's actual diluted EPS of $2.40, and in 2022 to $2.70 (from $2.50), 14% below our 2021 estimate. The main reasons for the EPS decline in 2022 reflect the winding down of the PPP (and related decrease in recognition of deferred processing fees), the absence of securities gains, a larger loss provision, and a drop in mortgage banking income, partly offset by a decrease in the cash flow loss provision. Loan demand appears to be solid, with our estimate for loan growth in both 2021 and 2022 at 8%. Our loan loss provision estimate is zero in 2021 and $0.7 million in 2022, well below the level of 2020's $1.95 million, which reflected the bulking up of loan loss reserves in preparation for the possibility of asset quality deterioration due to economic distress caused by COVID-19 (which failed to materialize, as asset quality remains strong). Factors adding to CPKF's expense burden include several new hires, greater IT expense for CPKF's new on-line banking platform, higher depreciation from the opening of a new tech center, and the opening of a new full-service branch. CPKF recently approved a second increase in the quarterly dividend this year of 8% per share, to $0.14 from $0.13, which follows an earlier 4% quarterly dividend increase in January. Notably, CPKF has increased the annual dividend payment every year for the past thirty years since 1991. In 2021 for the fourteenth consecutive year, CPKF was included in the American Banker magazine list of the "Top 200 Community Banks".

SUMMARY DATA

52-Week High	**$30.25**
52-Week Low	**$19.75**
One-Year Return (%)	**48.07**
Beta	**0.79**
Average Daily Volume (sh)	**1,568**
Shares Outstanding (mil)	**5**
Market Capitalization ($mil)	**$144**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**4**
Insider Ownership (%)	**40**
Annual Cash Dividend	**$0.56**
Dividend Yield (%)	**1.87**
5-Yr. Historical Growth Rates	
Net Revenue (%)	**7.1**
Earnings Per Share (%)	**11.9**
Dividend (%)	**5.2**
P/E using TTM EPS	**9.1**
P/E using 2021 Estimate	**9.5**
P/E using 2022 Estimate	**11.1**
Zacks Rank	**N/A**

Risk Level	**Average**
Type of Stock	**Small-Value**
Industry	**Banks-Southeast**
Zacks Rank in Industry	**N/A**

ZACKS ESTIMATES

Net Revenue
(in millions of $)

	Q1 (Mar)	**Q2** (Jun)	**Q3** (Sep)	**Q4** (Dec)	**Year** (Dec)
2019	11.3 A	13.0 A	12.9 A	12.6 A	49.8 A
2020	13.3 A	12.2 A	13.7 A	13.9 A	53.1 A
2021	15.5 A	15.3 A	15.3 A	14.6 E	60.7 E
2022					58.2 E

Earnings per Share*
(EPS is operating earnings before nonrecurring items)

	Q1 (Mar)	**Q2** (Jun)	**Q3** (Sep)	**Q4** (Dec)	**Year** (Dec)
2019	0.60 A	0.66 A	0.65 A	0.39 A	2.29 A
2020	0.68 A	0.42 A	0.69 A	0.61 A	2.40 A
2021	1.08 A	0.82 A	0.78 A	0.47 E	3.15 E
2022					2.70 E

*Quarterly EPS may not add to total due changes in average shares outstanding. Adjusted for 6-for 5- stock dividend on October 15, 2019.

THIRD QUARTER

CPKF's third quarter net earnings increased $0.4 million, or 11%, year over year to $3.8 million, while 2021's third quarter diluted EPS soared by $0.09, or 13%, to $0.78 from $0.69 posted a year ago.

This was well above our estimate, which had called for a $0.6 million decrease in net earnings to $2.8 million and a $0.11 decline in diluted EPS to $0.58.

The main factors behind the difference between actual results and our estimate were: (1) net interest income was $1.2 million higher than our estimate due to a larger-than expected contribution from PPP income recognized during 2021's third quarter of $1,178,000, as well as higher average interest-earning assets; (2) noninterest income was $0.8 million, or 14%, more than we had estimated due to better-than-expected contributions from all segments; (3) the provision for loan losses swung a positive $0.7 million to a credit of $525,000 (i.e., a reversal of the loss provision) from an estimated charge (provision) of $175,000; and (4) income tax expense was $0.2 million less than our estimate due to an effective tax rate of 2.7% that was 5.9 points lower than our 8.6% estimate. These were partly offset by: (1) the provision for cash mangement losses that came in at $1.0 million versus our $30,000 estimate offset and (1) other miscellaneous expense that was $0.9 million more than projected.

The major reasons for the third quarter's $0.4 million, or 11%, increase in net earnings versus the prior-year quarter were a $1.6 million, or 12%, gain in net revenues, as growth in net interest income (up $2.4 million, or 29%) was partly offset by an $0.8 million, or 14%, decline in other noninterest income. The decrease in noninterest income reflected a $0.6 million drop in mortgage banking income on weaker activity as well as a $0.2 million fall in other miscellaneous income. In addition, earnings benefitted from a $1.15 million decline in the provision for loan losses to a credit (reversal) of $525,000 from a charge (provision) of $625,000 in the prior year. Moreover, income tax payments were $0.5 million lower due to a reduced effective tax rate that was 11.8 points less than a year ago. These positives were partly offset by a $2.9 million, or 32%, increase in total noninterest expense, largely stemming from a $0.5 million rise in compensation costs (up 8%), a $1.0 million advance in the provison for cash management losses, a $1.3 million jump in other miscellaneous expense (up 46%), and a $0.1 million (19%) rise in occupancy costs.

We are again raising our 2021 diluted EPS estimate by $0.20 to $3.15 from $2.95, 32% above 2020's actual diluted EPS of $2.40. Our diluted EPS estimate for 2022 increases by the same amount—to $2.70 from $2.50, $0.45 or, 14%, below our 2021 estimate. The main reasons for the EPS decline in 2022 reflect the winding down of the PPP (and related decrease in recognition of deferred processing fees of an estimated $4.13 million in 2021), the absence of securities gains ($730,000 in 2021 to date), a loss provision of $0.7 million (compared to zero in 2021), and a $0.7 million drop in mortgage banking income, partly offset by a $1.3 million decrease in the cash flow loss provision.

First, CPKF has participated in the Paycheck Protection Program (PPP), designed to provide a direct incentive for small businesses to keep their workers on the payroll. The Small Business Administration (SBA) will forgive loans if all employees are kept on the payroll for eight weeks and the money is used for payroll, rent, mortgage interest, or utilities. PPP loans are guaranteed by the SBA for 100% of amount of the PPP loan not forgiven. Loans issued prior to June 5, 2020 have a maturity of 2 years and 5 years after that. All loans have an interest rate of 1%. In addition, lenders receive fees for processing the PPP loans: 5% for loans of $350,000 or less, 3% for loans between $350,000 and $2 million, and 1% for loans of $2 million or more. (We note these amounts have been tweaked under new provisions when the Consolidated Apropriations Act (CAA) was signed into law on December 27, 2020. The CAA provides for two types of PPP loans, initial or first-draw loans up to $10 million, for entities that have never received a PPP loan, and second-draw loans up to $2 million for entities that have. The Paycheck Protection Program ended on May 31, 2021).

PPP loans provide for the deferral of payments for a period of 6 months, including payment of principal, interest and fees. Interest will accrue, but payments will not be required during the first 6 months. Processing fees will be amortized over the contract life and adjusted based on actual prepayments. Upon notification from the SBA of the amount of the PPP loan to be forgiven, acceleration of recognition of deferred processing fees will occur for the percentage of the loan forgiven.

Through the end of September 2020, CPKF had generated about $77 million of PPP loans, of which $0.2 million remained outstanding at September 30, 2021. PPP loans that were originated in 2021 under the CAA totaled $36 million, with a remaining $11.7 million outstanding as of September 30, 2021.

The PPP loans will have countervailing impacts on the CPKF's net interest margin. First, the 1% annual interest rate is lower than is typical for CPKF loans, which will tend to reduce the NIM. However, PPP processing fees, amortized over the life of the loan, will add to the NIM. Moreover, when a PPP loan is forgiven, any deferred processing fee will also be added to the NIM. We have estimated a net interest margin of 3.30% for full-year 2021, but reduced our estimate for full-year 2022 by 5 basis points to 3.25%, with both estimates excluding any impact from the recognition of deferred processing fees.

The NIM will be supplemented in 2021 by the recognition of deferred processing fees. Of total deferred processing fees of about $2.97 million earned during 2020, only $770,000 was taken into income during 2020 while $1.89 million was recognized in 2021's first quarter. Moreover, we estimate that deferred processing fees earned from new PPP loans added under the CAA in 2021 generated an additional $1.52 million of deferred fees in the first quarter and $420,000 in the second quarter, of which $1,178,000 was recognized in the third quarter, significantly more than the $660,000 recognized in the second quarter. The remaining $0.4 million balance of deferred processing fees will likely be booked into income during during the final quarter of 2021.

For 2021, we are cutting our estimate of the loan loss provision from $0.7 million to $0.0 million, following the $525,000 reversal of the loss provision in the third quarter. This compares to 2020's $1.95 million loss provision, which reflected the bulking up of loan loss reserves in preparation for the possibility of asset quality deterioration due to economic distress caused by COVID-19 (which failed to materialize, as asset quality remains strong). For 2022, our initial estimate for the loan loss provision remains $0.7 million.

The provision for cash flow losses, a separate line item listed under other noninterest expense, is raised from $0.12 million to $1.44 million in 2021. This follows the $1.0 million rise in the loss provision during the third quarter and an estimated $350,000 bump in the fourth quarter to beef up loss reserves going forward. These adjustments stem from the bankruptcy of one $2.3 million credit, for which there is no expectation of any recovery, but which is now fully written off.

There are other factors adding to CPKF's expense burden going forward. CPKF expects several new hires to increase compensation costs. CPKF's digital strategy for its new on-line banking platform requires investing in new technology, leading to higher IT expense. CPKF recently opened a new tech center, which will house IT oerations, marketing, and merchant card processing, and will add to depreciation expense beginning in 2021's third quarter. Finally, the Company added a full-service branch to its network in the third quarter of 2020, which will also increase expenses.

Loan demand, other than for PPP loans, appears to be solid, and we are maintaining our recently increased estimate of loan growth in both 2021 and 2022 at 8%.

We are increasing our estimate for merchant services income by $0.2 million to $4.2 million, with $4.3 million our estimate for 2022. We are also raising our estimate of cash management fee income to $1.8 million from $1.5 million in 2021 and to $2.0 million from $1.7 million in 2022, as growth is coming in a bit higher than anticipated.

For the first time in 2021, CPKF has shown a separate line item for its mortgage banking operations (previously included in other income), while at the same time folding the ATM income line item into other income. Our stand-alone estimates for mortgage banking income are $3.0 million in 2021 (up from $2.4 million previously) and $2.3 million in 2022 (up from $1.8 million before).

For the second time this year, Chesapeake Financial Shares increased the quarterly dividend. On October 14, 2021, the Board of Directors raised the dividend by 8% to $0.14 per share from $0.13 per share, payable on December 15, 2021, to shareholders of record at December 1, 2021. This follows a 4% dividend increase to $0.13 per share from $0.125 per share declared in January 2021 and paid on March 15, 2021. Notably, CPKF has increased the annual dividend payment every year for the past thirty years since 1991.

In 2021 for the fourteenth consecutive year, Chesapeake Financial Shares, Inc. has been included in the American Banker magazine listing of the “Top 200 Community Banks” in the United States. The bank ranked at #117 in the nation out of approximately 479 publicly traded banks and thrifts with less than $2 billion in assets in the study, up from #148 when CPKF first broke into the rankings in 2008. The ranking is based on a three-year average of return on average equity (ROAE), which for CPKF was 11.14%. Chesapeake Bank again garnered a top ranking in the American Banker’s list of “Best Banks to Work for”, and had a #24 spot in 2020, out of the 85 banks listed.

Below, we discuss third quarter results more fully. Our projections are shown at the back of the report.

<u>Net Interest Income</u>
Net interest income increased $2.4 million, or 29%, year over year in the third quarter to $10.8 million ($1.2 million above our estimate), as a 23% increase in average interest-earning assets added to a 3.88% net interest margin, 15 basis points below the 3.73% earned in the year-ago quarter, but above our 3.30% estimate (which excluded the PPP impact). We note that net interest income (and the net interest margin) benefitted from the recognition of deferred processing fees on PPP loans of $1,178,000 during the quarter.

The NIM will be supplemented in 2021 by the recognition of deferred processing fees. Of total deferred processing fees of about $2.97 million earned during 2020, only $770,000 was taken into income during 2020 while $1.89 million was recognized in 2021’s first quarter. Moreover, we estimate that deferred processing fees earned from new PPP loans added under the CAA in 2021 generated an additional $1.52 million of deferred fees in the first quarter and $420,000 in the second quarter, of which $1,178,000 was recognized in the third quarter, significantly more than the $660,000 recognized in the second quarter. The remaining $0.4 million balance of deferred processing fees will likely be booked into income during during the final quarter of 2021.

We have estimated a net interest margin of 3.30% for full-year 2021 and 3.25% for full-year 2022, with both estimates excluding any impact from the recognition of deferred processing fees.

We note CPKF’s balance sheet was asset sensitive at the end of the third quarter, which will likely expand the net interest margin in a rising interest-rate environment, but could hurt should interest rates fall.

<u>Noninterest Income</u>
Noninterest income fell by $0.8 million, or 14%, to $4.5 million from $5.3 million in the prior-year quarter. The decrease in noninterest income primarily reflected a $0.6 million drop in mortgage banking income on weaker activity as well as a $0.2 million fall in other miscellaneous income.

We are increasing our estimate for merchant services income by $0.2 million to $4.2 million, with $4.3 million our estimate for 2022. We are also raising our estimate of cash management fee income to $1.8 million from $1.5 million in 2021 and to $2.0 million from $1.7 million in 2022, as growth is coming in a bit higher than anticipated.

For the first time in 2021, CPKF has shown a separate line item for its mortgage banking operations (previously included in other income), while at the same time folding the ATM income line item into other income. Our stand-alone estimates for mortgage banking income are $3.0 million in 2021 (up from $2.4 million previously) and $2.3 million in 2022 (up from $1.8 million before).

Because of these items, we have increased our 2021 estimate for noninterest income $2.4 million to $19.7 million from $17.3 million previously, with our new estimate for 2022 at $18.3 million (up from $17.1 million before).

Loss Provision

The provision for loan losses benefitted from a $1.15 million improvement during the third quarter to a credit (reversal) of $525,000 from a charge (provision) of $625,000 in the prior-year quarter. Loan loss reserves decreased $0.6 million year over year to $7.0 million (1.11% of loans), which was below the second quarter's loss reserve of $7.7 million, or 1.24% of loans, as well as above the $7.6 million (1.22% of loans) posted in the year-ago quarter.

Including the loss allowance for cash flow receivables, the total loss allowance declined $1.6 million to $7.7 million (1.18% of loans plus cash flow receivables) compared with $9.7 million (1.52% of loans plus cash flow receivables) at the end of the previous quarter, and was below the $9.3 million (1.45% of loans plus cash flow receivables) at the end of the comparable year-ago quarter.

As to other asset quality measures, CPKF recorded $144,000 of net charge-offs in the third quarter. This compares to $747,000 of net loan loss recoveries in the year-ago quarter and net loan loss recoveries of $256,000 for the full year in 2020. In addition, during the third quarter CPKF reported $2.4 million of net charge-offs in its cash flow operation (compared to zero a year ago), stemming from the bankruptcy of one $2.3 million credit, for which there is no expectation of any recovery, but which is now fully written off.

For 2021, we are cutting our estimate of the loan loss provision from $0.7 million to $0.0 million, following the $525,000 reversal of the loss provision in the third quarter. This compares to 2020's $1.95 million loss provision, which reflected the bulking up of loan loss reserves in preparation for the possibility of asset quality deterioration due to economic distress caused by COVID-19 (which failed to materialize, as asset quality remains strong). For 2022, our initial estimate for the loan loss provision remains $0.7 million.

We project that the total loss allowance will drop to 1.21% of total loans plus receivables at yearend 2021, down from 1.47% at the end of 2020, before falling to 1.12% at yearend 2022.

Noninterest Expense

There was a $2.9 million, or 32%, increase in total noninterest expense, largely stemming from a $0.5 million rise in compensation costs (up 8%), a $1.0 million advance in the provison for cash management losses following the bankruptcy of one $2.3 million credit, a $1.3 million jump in other miscellaneous expense due to an accumulation of various one-time items (up 46%), and a $0.1 million (19%) rise in occupancy costs.

Reflecting higher expenses, the efficiency ratio deteriorated, increasing to 78.1% from 66.4% in the year-ago quarter, and was worse than the second quarter's 68.3%.

We project that compensation costs will increase from $22.7 million actual in 2020 to $23.3 million in 2021 and $24.6 million in 2022.

We are raising our estimate of noncompensation costs in 2021 to $19.2 million from $16.0 million before, primarily due to increases in the cash flow loss provision and other miscellaneous expenses, which we expect to revert to trend line in 2022, with total noncompensation costs decreasing $1.9 million to an estimated $17.3 million in 2022. Our estimate of the efficiency ratio is 70.8% in 2021 and 72.1% in 2022, compared to 72.0% actual in 2020.

Income Taxes
The Company had a 2.7% effective tax rate in the third quarter as CPKF reversed part of the third quarter's overaccrual of taxes. This compares to a 14.5% tax rate in the year-ago quarter and our estimate of an effective tax rate of 8.6%.

For the fourth quarter, we are using a 20.0% effective tax rate. For the year, we are estimating an effective tax rate 16.0% in 2021 and 16.0% in 2022. This compares to a full-year effective tax rate of 14.8% in 2020.

Net Income
CPKF's third quarter net earnings increased $0.4 million, or 11%, year over year to $3.8 million, while 2021's third quarter diluted EPS soared by $0.09, or 13%, to $0.78 from $0.69 posted a year ago.

This was well above our estimate, which had called for a $0.6 million decrease in net earnings to $2.8 million and a $0.11 decline in diluted EPS to $0.58.

Profitability
CPKF posted a 11.7% ROE and 1.15% ROA for the third quarter of 2021, compared to 11.8% and 1.18%, respectively, in the prior-year quarter.

Loans and Asset Quality
Gross loans increased $12 million, or 2%, year over year, and rose $13 million, or 2%, sequentially to $632 million, reflecting solid loan growth.

By category, commercial real estate loans increased $10.4 million, or 4%, to $268 million; 1-4 family gained $8.8 million, or 6%, to $151 million; construction and land development loans rose $6.5 million, or 12%, to $59 million; other loans jumped $4.5 million, or 15%, to $37 million; consumer loans increased $2.2 million, or 28%, to $10 million and cash flow receivables gained $1.4 million, or 8%, to $19 million. Negatively, commercial and industrial loans dropped $21.2 million, or 16%, to $108 million, reflecting a decline in PPP loans.

Loan demand, other than for PPP loans, appears to be solid, and we are maintaining our recently increased estimate for loan growth in both 2021 and 2022 at 8%.

Asset quality measures improved modestly during the third quarter. Total nonperforming assets fell $0.2 million to $5.9 million from $6.1 million sequentially. Nonaccrual loans decreased by $0.2 million to $2.2 million from $2.4 million, while other real estate owned was flat at $2.7 million. Restructured loans was flat at $1.0 million. In total, nonperforming assets (NPAs), including troubled debt restructurings that are current in payments, decreased 6 basis points to 0.89% of outstandings + OREO at September 30, 2021 from 0.95% of outstandings + OREO at June 30, 2021, and fell 41 basis points year over year from 1.30%.

The loss allowance as a percent of nonperforming assets decreased to 131% from 160% sequentially, as improvement in nonperforming assets was more than offset by a decrease in the loss reserve for loans plus cash flow receivables.

Liquidity and Funding
Cash and equivalents decreased by $26 million to $27 million at the end of the third quarter, while the securities portfolio rose $42 million to $585 million. By category, the municipal securities portfolio increased $34 million to $366 million, the private-label mortgage securities portfolio decreased $1 million to $89 million, US government-related securities gained $6 million to $80, and asset-backed securities (primarily student loans under the FFELP program) rose $3 million to $50 million.

On a relative basis, municipal securities were 63% of the entire available-for-sale securities portfolio, the private-label mortgage securities portfolio was 15%, US government-related securities were 14%, and asset-backed securities and other were 8%.

CPKF's liquidity ratios worsened compared to the previous quarter. At September 30, 2021, liquid assets represented 8% of total assets (10% at the end of the second quarter) and covered purchased funds by 115% (down from 152%), while loans plus receivables accounted for 49% of total assets (49% at June 30, 2021).

Core deposits rose $29 million sequentially to $1,074 million and funded 165% of loans and receivables.

Capital Adequacy and Dividends

The Company's capital adequacy ratios declined during the third quarter, as growth in risk-weighted assets outpaced growth in Tier 1 capital. The Tier 1 capital ratio fell 49 basis points sequentially to 13.34% at the end of 2021's third quarter from 13.83% at June 30, 2021, while the Total capital ratio decreased 89 basis points, dropping to 16.40% from 17.29%.

Total shareholders' equity decreased $1.6 million during the third quarter, as a $3.1 million advance in retained earnings was more than offset by a $3.9 million decline in accumulated other comprehensive income plus a negative $0.8 million in capital changes.

Reflecting these factors plus a 31,000 decrease in common shares outstanding, tangible book value per share declined during the third quarter, by $0.16 per share to $26.62 from $26.78. The total equity to total assets ratio worsened, decreasing by 39 basis points to 9.64% from 10.03%, as growth in total assets ouptpaced growth in common shareholders' equity.

OVERVIEW

Chesapeake Financial Shares, Inc. (CPKF or the Company) is a financial holding company headquartered in Kilmarnock, Virginia, with $1,329 million in total assets at September 30, 2021. CPKF is predominantly a small business lender with 16 branch offices that serve customers in the eastern region of Virginia between the Potomac and James Rivers. CPKF, which began as Lancaster National Bank on April 13, 1900, has a long history and strong ties with the communities it serves.

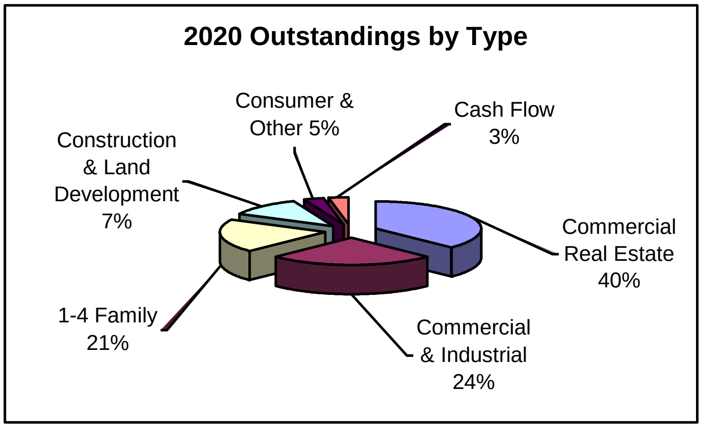
Operations are carried on through Chesapeake Bank, a state-chartered bank as well as Federal Reserve and FDIC member bank, and Chesapeake Wealth Management, an independent wealth management firm with trust powers that manages about $510 million in assets (at 2020 yearend) through its subsidiaries involved in asset management (Chesapeake Wealth Management is a registered investment adviser), brokerage, and trust services. Other activities of the Company include Chesapeake Payment Systems, Cash Flow program, and its secondary market mortgage banking operation.

Chesapeake Payment Systems offers merchant processing services such as credit card and debit card processing, electronic benefits transfers, and loyalty and gift card processing to companies involved in travel, entertainment, restaurant, hospitality, retail, mail order, and e-commerce. At yearend 2020, Chesapeake Payment Systems had 563 direct merchants in its system and processed over $509 million in merchant card transactions. In addition, Chesapeake Payment Systems has also partnered with seven independent sales organizations (ISOs) to expand its processing footprint.

The Cash Flow program, which provides an attractive financing option to growing businesses, involves the purchase of the client company's accounts receivables. The Cash Flow program is currently offered in the Eastern half of the United States and had 60 customers at the end of 2020.

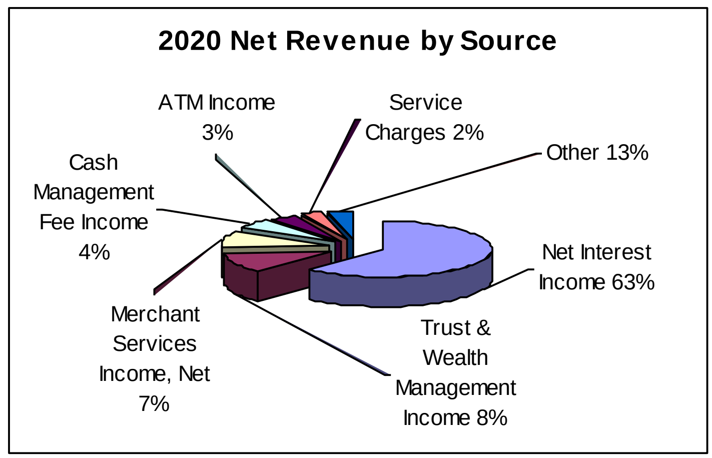
Through Chesapeake's secondary market mortgage banking operation, the Company services a $292 million loan portfolio (as of December 31, 2020) of residential mortgage loans for Federal Home Loan

Mortgage Corporation (FHLMC or Freddie Mac), for which it earns a 25 basis-point fee (approximately $667,000 annually) on the outstanding loan portfolio balance. Additionally, CPKF earns a pare-off fee for residential mortgage loans that are originated and closed with FHLMC, which added $2.8 million to revenues in 2020 (both types of fees are included in other noninterest income in the Company's financial statements).



The lending portfolio is dominated by real estate loans, as shown in the chart at left. At December 31, 2020, the lending book consisted of commercial real estate (accounting for 40% of total gross outstandings), commercial and industrial (24%), 1-4 family (21%), construction and land development (7%), consumer and other (5%), and cash flow (3%). A majority of loans are secured, usually by real estate, inventory, accounts receivable, equipment, machinery, or corporate assets.

At December 31, 2020, the liquidity portfolio, which consists of cash, short-term investments, federal funds sold, and US agency mortgage obligations, represented about 10% of total assets and 11% of the securities portfolio. In addition, the available-for-sale portfolio includes municipal at 61% of the total, private label mortgage securities at 19%, and asset-backed and other securities at 9%. Core deposits represented 98% of total deposits at December 31, 2020, with certificates of deposit larger than $250,000 at 3%.



In 2020, net interest income contributed 63% of net revenue, with a significant 37% coming from noninterest income sources. Major contributors to noninterest income include trust and wealth management income (8% of net revenues), merchant services income, net (7%), cash management fee income (4%), ATM income (3%), and service charges (2%).

VALUATION

CPKF stock is up 39.5% year to date, a better performance than the 25.1% price increase for the S&P 500, and just below the 41.2% median price gain for the small-cap bank industry, as shown in the following table.

At its current price, CPKF is trading on par with the industry median P/E, based upon our current CPKF EPS estimate for 2022. Assuming a small-cap bank industry valuation of 11.1X for 2022, CPKF's target price based upon our 2022 EPS estimate is about $30.00.

Turning to Price/Tangible Book Value, CPKF is currently valued at 1.13X. Assuming CPKF trades at the median 1.17X tangible book value of the small-cap bank industry and based upon our estimated book value for CPKF twelve months out, our target price is about $32.75, which compares to CPKF's current book value of $26.62.

We have chosen the $31.50 midpoint of the range of values based upon CPKF's 2022 P/E of $30.00 and forward Price/Tangible Book Value of $32.75 as our new valuation.

Industry Comparables - Small-cap Banks

	Pr Chg YTD	EPS TTM*	EPS 2021E	EPS 2022E	ROE TTM*	ROE 5-Yr Avg	ROA TTM*	ROA 5-Yr Avg	Div Yld
Chesapeake Finc'l	**39.5**	**9.1**	**9.5**	**11.1**	**12.7**	**11.0**	**1.26**	**1.18**	**1.9**
S&P 500	**25.1**	**26.8**	**23.4**	**21.4**	**-----**	**-----**	**-----**	**-----**	**1.3**
Median	**41.2**	**9.6**	**9.5**	**11.1**	**12.6**	**9.8**	**1.23**	**1.04**	**2.3**
Average	43.4	10.1	10.2	11.3	13.0	10.6	1.2	1.1	2.0
High	120.3	21.3	22.6	20.7	24.7	20.0	2.1	2.1	4.4
Low	4.2	6.2	6.5	7.6	4.5	2.7	0.4	0.2	-----

*Trailing twelve months

Chesapeake Financial Shares, Inc.

Income Statement and Balance Sheet

(Dollars in millions, except per share data)

Summary Financial Data	**12/16**	**12/17**	**12/18**	**12/19**	**12/20**	**12/21E**	**12/22E**
Net interest income	24.4	26.0	27.4	29.5	33.5	41.0	39.9
Non-interest income	14.7	18.1	18.6	20.3	19.6	19.7	18.3
Total net revenue	39.1	44.1	46.0	49.8	53.1	60.7	58.2
Loan loss provision	0.5	0.9	0.5	0.5	2.0	(0.0)	0.7
Non-interest expense	30.4	31.8	33.3	36.0	37.3	42.5	41.9
Income taxes & other	1.2	2.5	1.4	1.9	2.1	2.9	2.5
Zacks adjusted income before NRI	7.0	8.9	10.8	11.4	11.7	15.3	13.1
GAAP net income	7.0	8.9	10.8	11.4	11.7	15.3	13.1
Diluted EPS before NRI	1.42	1.80	2.17	2.29	2.40	3.15	2.70
Reported EPS	1.42	1.80	2.17	2.29	2.40	3.15	2.70
Dividends per share	0.41	0.43	0.46	0.49	0.50	0.53	0.56
Liquid assets	40.6	50.6	73.1	98.0	120.2	106.6	102.4
Outstandings, gross	481.4	523.7	546.0	566.7	625.0	652.8	706.7
Total assets	720.8	785.2	854.8	958.3	1,204.7	1,356.6	1,497.5
Core deposits	522.3	632.4	702.0	799.5	984.2	1,094.4	1,208.0
Purchased funds	97.4	53.1	47.2	39.6	85.3	93.6	95.1
Long-term debt	16.1	5.2	5.2	5.2	5.2	25.2	25.2
Shareholders' equity	77.9	86.8	92.7	105.4	122.7	129.6	140.0
Profitability							
Return on avg assets	0.99%	1.16%	1.32%	1.22%	1.06%	1.19%	0.92%
Return on avg equity	8.89%	10.64%	12.07%	11.09%	10.27%	12.09%	9.68%
Net interest margin	4.38%	4.30%	4.10%	3.98%	3.80%	3.75%	3.25%
Loan loss provision % avg assets	0.08%	0.12%	0.06%	0.06%	0.18%	(0.00)%	0.05%
Noninterest income % avg assets	2.06%	2.34%	2.27%	2.18%	1.76%	1.53%	1.28%
Noninterest expense % avg assets	4.28%	4.11%	4.06%	3.86%	3.36%	3.30%	2.94%
Preprovision pretax income % avg assets	1.23%	1.59%	1.55%	1.48%	1.42%	1.42%	1.14%
Tangible efficiency ratio	78%	72%	73%	75%	72%	71%	72%
Payout ratio	29%	24%	21%	21%	21%	17%	21%
Asset Quality							
Net charge-offs % avg outstandings	0.18%	0.27%	0.02%	0.10%	(0.05)%	0.06%	0.12%
Allowance % outstandings	1.34%	1.17%	1.22%	1.18%	1.47%	1.21%	1.12%
NPAs % loans + OREO	2.21%	1.73%	1.93%	1.36%	1.11%	0.92%	0.97%
Allowance % NPAs	60%	68%	63%	86%	132%	131%	116%
Liquidity & Funding							
Liquid assets % purchased funds	42%	95%	155%	247%	141%	114%	108%
Core deposits % outstandings	108%	121%	129%	141%	157%	168%	171%
Liquid assets % assets	6%	6%	9%	10%	10%	8%	7%
Outstandings % assets	67%	67%	64%	59%	52%	48%	47%
Capital Adequacy							
Total equity % assets	10.81%	11.05%	10.85%	11.00%	10.18%	9.56%	9.35%
Tangible equity % assets	10.81%	11.05%	10.85%	11.00%	10.18%	9.56%	9.35%
Tier 1 capital ratio	14.16%	14.35%	15.04%	15.03%	14.03%		
Total capital ratio	15.30%	15.37%	16.08%	16.00%	15.20%		
Parent Company Statistics							
Interest coverage	9.6X	12.7X	8.2X	12.4X	41.2X	25.5X	25.5X
Interest & dividend coverage	0.5X	0.8X	0.6X	1.0X	2.0X	1.8X	1.8X
Short-term debt coverage	Lge	Lge	Lge	Lge	Lge	Lge	Lge
Total debt coverage	1.2X	2.8X	2.7X	5.0X	4.8X	5.1X	5.1X
Double leverage	102.6%	102.3%	102.6%	102.5%	102.1%	108.4%	109.7%

Chesapeake Financial Shares, Inc.

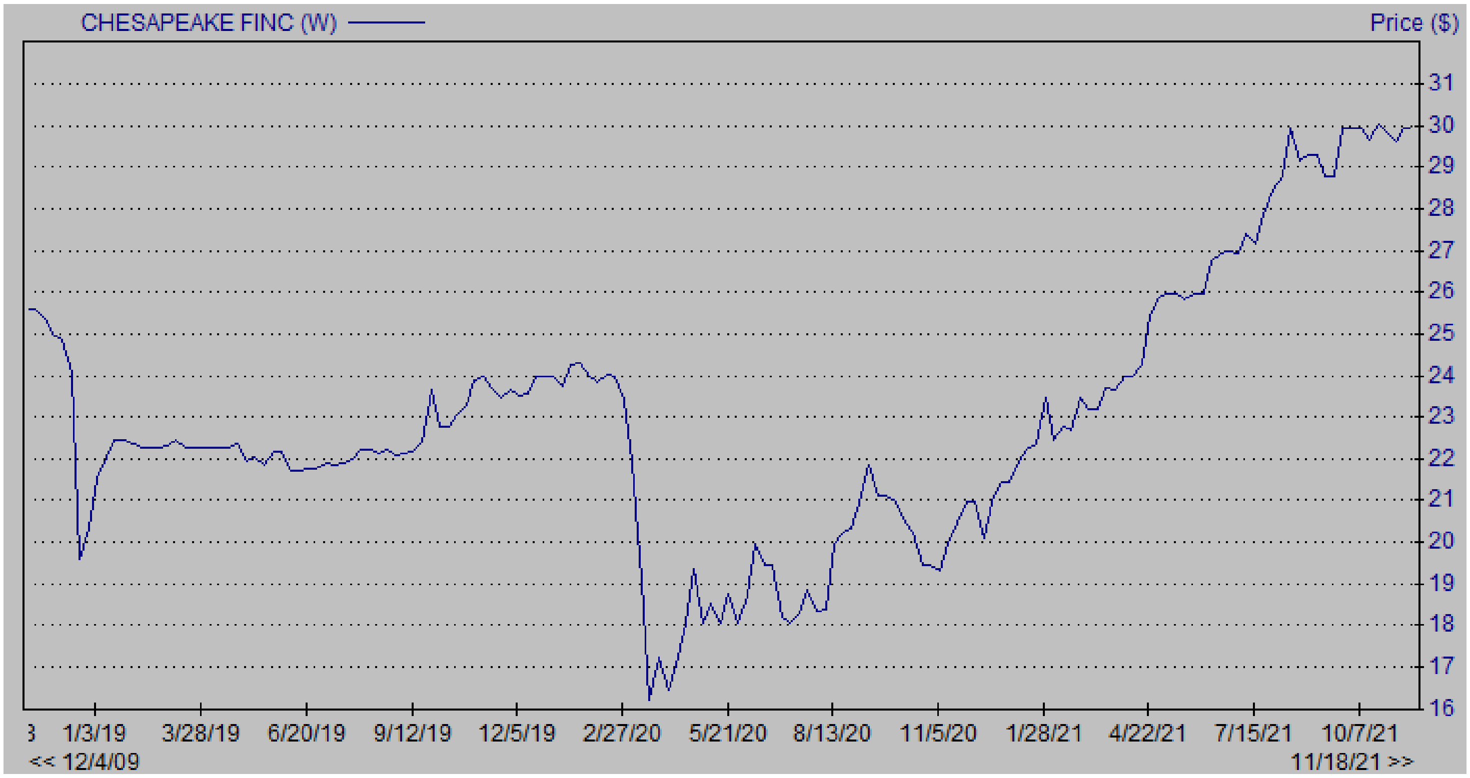
Income Statement and Balance Sheet

(Dollars in millions, except per share data)

	2020				2021			
Summary Financial Data	**Q1 A**	**Q2 A**	**Q3 A**	**Q4 A**	**Q1 A**	**Q2 A**	**Q3 A**	**Q4 E**
Net interest income	7.6	8.2	8.4	9.3	10.8	9.7	10.8	9.8
Non-interest income	5.7	4.0	5.3	4.6	4.7	5.6	4.5	4.8
Total net revenue	13.3	12.2	13.7	13.9	15.5	15.3	15.3	14.6
Loan loss provision	0.5	0.6	0.6	0.2	0.2	0.2	(0.5)	0.2
Non-interest expense	8.8	9.3	9.1	10.2	9.0	9.9	11.9	11.6
Income taxes & other	0.6	0.2	0.6	0.6	1.0	1.2	0.1	0.5
Zacks adjusted income before NRI	3.4	2.1	3.4	2.9	5.3	4.0	3.8	2.3
GAAP net income	3.4	2.1	3.4	2.9	5.3	4.0	3.8	2.3
Diluted EPS before NRI	0.68	0.42	0.69	0.61	1.08	0.82	0.78	0.47
Reported EPS	0.68	0.42	0.69	0.61	1.08	0.82	0.78	0.47
Dividends per share	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.14
Liquid assets	83.1	96.0	114.1	120.2	101.4	128.1	107.6	106.6
Outstandings, gross	563.2	639.3	639.6	625.0	648.6	637.8	651.8	652.8
Total assets	951.4	1,114.7	1,172.2	1,204.7	1,238.3	1,292.7	1,328.8	1,356.6
Core deposits	796.4	901.7	955.0	984.2	1,023.5	1,045.3	1,074.1	1,094.4
Purchased funds	37.6	84.6	84.0	85.3	78.5	84.4	93.2	93.6
Long-term debt	5.2	5.2	5.2	5.2	5.2	25.2	25.2	25.2
Shareholders' equity	104.9	113.2	116.9	122.7	122.0	129.7	128.0	129.6
Profitability								
Return on avg assets*	1.41%	0.79%	1.18%	0.99%	1.72%	1.25%	1.15%	0.68%
Return on avg equity *	12.81%	7.52%	11.76%	9.84%	17.21%	12.61%	11.71%	7.08%
Net interest margin*	3.79%	3.88%	3.73%	3.83%	4.21%	3.66%	3.88%	3.25%
Loan loss provision % avg assets*	0.22%	0.24%	0.22%	0.06%	0.06%	0.06%	(0.16)%	0.05%
Noninterest income % avg assets*	2.37%	1.55%	1.85%	1.55%	1.56%	1.76%	1.38%	1.44%
Noninterest expense % avg assets*	3.68%	3.58%	3.17%	3.44%	2.96%	3.14%	3.64%	3.44%
Preprovision pretax inc.% avg assets*	1.88%	1.14%	1.60%	1.25%	2.12%	1.69%	1.02%	0.90%
Tangible efficiency ratio	73%	76%	66%	73%	58%	68%	78%	79%
Payout ratio	18%	30%	18%	21%	12%	16%	17%	30%
Asset Quality								
Net charge-offs % avg outstandings*	0.01%	(0.07)%	(0.47)%	0.29%	(0.01)%	(0.03)%	1.55%	0.18%
Allowance % outstandings	1.28%	1.24%	1.45%	1.47%	1.46%	1.52%	1.18%	1.21%
NPAs % loans + OREO	1.37%	1.18%	1.30%	1.11%	0.99%	0.95%	0.89%	0.92%
Allowance % NPAs	93%	104%	91%	104%	145%	160%	131%	131%
Liquidity & Funding								
Liquid assets % purchased funds	221%	113%	136%	136%	129%	152%	115%	114%
Core deposits % outstandings	141%	141%	149%	154%	158%	164%	165%	168%
Liquid assets % assets	9%	9%	10%	10%	8%	10%	8%	8%
Outstandings % assets	59%	57%	55%	53%	52%	49%	49%	48%
Capital Adequacy								
Total equity % assets	11.03%	10.16%	9.98%	10.18%	9.85%	10.03%	9.64%	9.56%
Tangible equity % assets	11.03%	10.16%	9.98%	10.18%	9.85%	10.03%	9.64%	9.56%
Tier 1 capital ratio	15.05%	14.51%	14.20%	14.03%	14.05%	13.83%	13.34%	
Total capital ratio	16.07%	15.58%	15.42%	15.20%	15.19%	17.29%	16.40%	

*Annualized.

HISTORICAL STOCK PRICE



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