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Zacks Small-Cap Research

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Chesapeake Financial Shares, Inc. (CPKF-OTCQX)

CPKF: Second Quarter Better Than Expected

We have chosen the \$29.25 midpoint of the range of values based upon CPKF's 2023 P/E of \$27.25 and forward Price/Tangible Book Value of \$31.25 as our new valuation.

Current Price (07/28/22) **\$26.00**
Valuation **\$29.25**

OUTLOOK

CPKF's second quarter net earnings increased \$0.1 million, or 2%, year over year to \$4.1 million, while 2022's second quarter diluted EPS rose by \$0.04, or 5%, to \$0.86 from \$0.82 posted a year ago. This was better than our estimate, which had called for a \$0.6 million decrease in net earnings to \$3.4 million and a \$0.10 decline in diluted EPS to \$0.72. We note that last year's second quarter benefitted from the inclusion of \$660,000 of Paycheck Protection Program fees, which this quarter did not. The main factors behind the difference between actual results and our estimate were: (1) net interest income was \$0.5 million higher than our estimate due to a larger-than-expected net interest margin of 3.74% (versus our 3.40% estimate); (2) merchant services income was \$0.3 million higher than expected and (3) other miscellaneous income was \$0.2 million more than projected. These positives were partly offset by: (1) other miscellaneous expense that was \$0.1 million more than projected and (2) income tax expense that was \$0.2 million larger than our estimate due greater pretax earnings and a higher effective tax rate. The major reasons for the second quarter's \$0.1 million, or 2%, increase in net earnings versus the prior-year quarter were a \$0.7 million, or 0.5%, rise in net revenues, partly offset by noninterest expense that was \$1.0 million more than last year's second quarter. Additionally, income tax payments were \$0.4 million less than those a year ago due to lower pretax earnings and a much lower effective tax rate that was 7.0 points below last year's 23.2%. CPKF just increased the quarterly dividend by 7% to \$0.15 per share from \$0.14 per share, and has raised its annual dividend payment every year for the past thirty years since 1991.

SUMMARY DATA

52-Week High **\$31.00**
52-Week Low **\$25.00**
One-Year Return (%) **-5.81**
Beta **0.72**
Average Daily Volume (sh) **500**

Shares Outstanding (mil) **5**
Market Capitalization (\$mil) **\$123**
Short Interest Ratio (days) **N/A**
Institutional Ownership (%) **4**
Insider Ownership (%) **40**

Annual Cash Dividend **\$0.60**
Dividend Yield (%) **2.31**

5-Yr. Historical Growth Rates

Net Revenue (%) **9.1**
Earnings Per Share (%) **16.9**
Dividend (%) **5.4**

P/E using TTM EPS **8.8**

P/E using 2022 Estimate **9.0**

P/E using 2023 Estimate **8.4**

Zacks Rank **N/A**

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

ZACKS ESTIMATES

Net Revenue

(in millions of \$)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
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	14.4 A	60.5 A
2022	15.5 A	16.0 A	15.1 E	15.1 E	60.7 E
2023					63.7 E

Earnings per Share*

(EPS is operating earnings before nonrecurring items)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
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	0.42 A	3.11 A
2022	0.90 A	0.86 A	0.74 E	0.54 E	2.90 E
2023					3.10 E

*Quarterly EPS may not add to total due changes in average shares outstanding.

SECOND QUARTER

CPKF's second quarter net earnings increased \$0.1 million, or 2%, year over year to \$4.1 million, while 2022's second quarter diluted EPS rose by \$0.04, or 5%, to \$0.86 from \$0.82 posted a year ago.

This was better than our estimate, which had called for a \$0.6 million decrease in net earnings to \$3.4 million and a \$0.10 decline in diluted EPS to \$0.72.

We note that last year's second quarter benefitted from the inclusion of \$660,000 of Paycheck Protection Program fees, which this quarter did not.

The main factors behind the difference between actual results and our estimate were: (1) net interest income was \$0.5 million higher than our estimate due to a larger-than-expected net interest margin of 3.64% (versus our 3.40% estimate); (2) merchant services income was \$0.3 million higher than expected and (3) other miscellaneous income was \$0.2 million more than projected. These positives were partly offset by: (1) other miscellaneous expense that was \$0.1 million more than projected and (2) income tax expense that was \$0.2 million larger than our estimate due greater pretax earnings and a higher effective tax rate.

The major reasons for the second quarter's \$0.1 million, or 2%, increase in net earnings versus the prior-year quarter were a \$0.7 million, or 0.5%, rise in net revenues, as a \$1.1 million, or 12%, gain in net interest income was partly offset by a \$0.4 million, or 7%, decrease in other noninterest income. In addition, noninterest expense was \$1.0 million more than last year's second quarter due to greater compensation costs (up \$0.8 million) and growth in other miscellaneous expense of \$0.2 million. Income tax payments were \$0.4 million less than those a year ago due to lower pretax earnings and a much lower effective tax rate that was 7.0 points below last year's 23.2%.

The loan loss provision was flat year over year at \$175,000 (the same as our estimate). Loan loss reserves fell \$0.5 million from \$7.7 million (1.24% of loans) year over year, but rose \$0.3 million sequentially from \$6.9 million (1.01% of loans) to \$7.2 million (1.03% of loans) as of June 30, 2022.

As to other asset quality measures, CPKF had net recoveries of \$82,000 of loans in the second quarter. This is \$75,000 larger than the \$5,000 of net recoveries in the year-ago quarter and compares to net loan charge-offs of \$86,000 for full-year 2021. CEO Jeff Szyperski noted nonperforming assets were 0.460% of total assets on June 30, 2022 compared to 0.815% of total assets on June 30, 2021.

Gross loans outstanding increased \$85 million, or about 11%, year over year, and rose \$13 million, or 2%, sequentially to \$705 million.

CPKF posted a 17.5% ROE and 1.21% ROA for the second quarter of 2022, compared to 12.6% and 1.25%, respectively, in the prior-year quarter.

At the July 15, 2022 Chesapeake Financial Shares Board of Directors meeting, the Board raised the quarterly dividend to \$0.15 per share from \$0.14 per share (a 7% increase), payable on or before September 15, 2022. This follows two dividend increases in 2021. Notably, CPKF has increased the annual dividend payment every year for the past thirty years since 1991.

In 2022 for the fifteenth 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 #130 in the nation out of approximately 6,000 community banks 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 11.07%.

We are currently reviewing our estimates and valuation model and will issue a more comprehensive report when detailed financial information becomes available within the next few weeks.

OVERVIEW

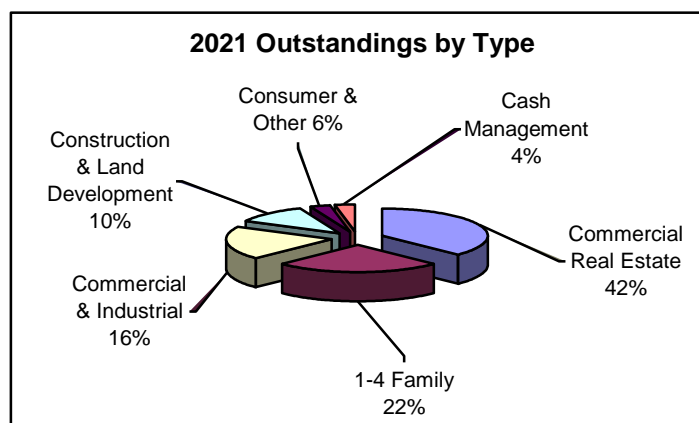
Chesapeake Financial Shares, Inc. (CPKF or the Company) is a financial holding company headquartered in Kilmarnock, Virginia, with \$1,342 million in total assets at June 30, 2022. CPKF is predominantly a small business lender with 16 branch offices that serve customers in the eastern region of Virginia 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 \$522 million in assets (at 2021 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 management program (now branded as Flexent) 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 2021, Chesapeake Payment Systems had 637 direct merchants in its system and processed over \$497 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 Flexent program, which provides an attractive financing option to growing businesses, involves the purchase of the client company's accounts receivables. The Cash management program is currently offered in the Eastern half of the United States and had 57 customers at the end of 2021.

Through Chesapeake's secondary market mortgage banking operation, the Company services a \$303 million loan portfolio (as of December 31, 2021) 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 million to revenues in 2020 (both types of fees are included in other noninterest income in the Company's financial statements).



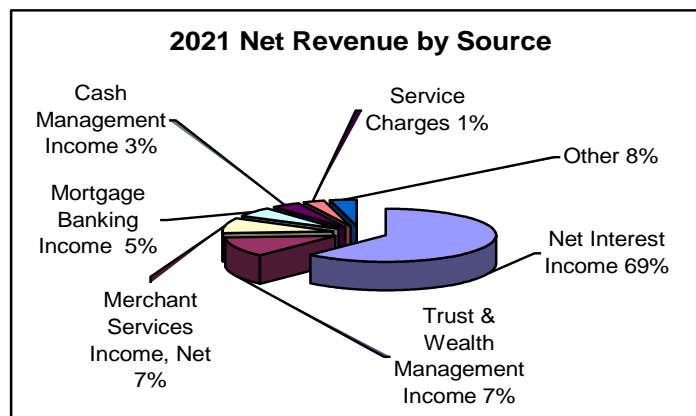
Source: Zacks Analyst

The lending portfolio is dominated by real estate loans, as shown in the chart at left. At December 31, 2021, the lending book consisted of commercial real estate (accounting for 42% of total gross outstandings), 1-4 family (22%), commercial and industrial (16%), construction and land development (10%), consumer and other (6%), and cash management (4%). A majority of loans are secured, usually by real estate, inventory, accounts receivable, equipment, machinery, or corporate assets.

At December 31, 2021, the liquidity portfolio, which consists of cash, short-term investments, federal funds sold, and US agency mortgage obligations, represented about 7% of total assets and 13% of the securities portfolio. In addition, the available-for-sale portfolio includes municipal at 62% of the total, private label mortgage securities at 17%, and asset-backed and other securities at 8%. Core deposits represented 98% of total deposits at December 31, 2020, with certificates of deposit larger than \$250,000 at 3%.

In 2021, net interest income contributed 69% of net revenue, with a significant 31% coming from noninterest income sources. Major contributors to noninterest income include trust and wealth management income (7% of net revenues), merchant services income, net (7%), mortgage banking income (5%), cash management fee income (3%), and service charges (2%).

Source: Zacks Analyst



VALUATION

CPKF stock is down 13.9% year to date, a better performance than the 14.6% price decrease for the S&P 500, but below the 5.7% median price decline for the small-cap bank industry, as shown in the following table.

At its current price, CPKF is trading 5% below the industry median P/E, based upon our current CPKF EPS estimate for 2023. Assuming a small-cap bank industry valuation of 8.8X for 2023, CPKF's target price based upon our 2022 EPS estimate is about \$27.25.

Turning to Price/Tangible Book Value, CPKF is currently valued at 1.44X. Assuming CPKF trades at the median 1.15X 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 \$31.25, which compares to CPKF's current book value of \$18.07.

We have chosen the \$29.25 midpoint of the range of values based upon CPKF's 2023 P/E of \$27.25 and forward Price/Tangible Book Value of \$31.25 as our new valuation.

Industry Comparables - Small-cap Banks

	Pr Chg YTD	EPS TTM*	EPS 2022E	EPS 2023E	ROE TTM*	ROE 5-Yr Avg	ROA TTM*	ROA 5-Yr Avg	Div Yld
Chesapeake Finc'l	(13.9)	9.3	9.4	8.8	12.8	11.4	1.05	1.19	2.3
S&P 500	(14.6)	19.4	18.0	17.3	-----	-----	-----	-----	1.6
Median	(5.7)	8.9	9.0	8.8	12.0	10.5	1.09	1.09	2.6
Average	(3.9)	9.3	9.4	9.0	12.2	11.2	1.1	1.1	2.4
High	33.1	17.6	18.4	18.2	21.2	19.2	2.0	2.0	5.2
Low	(23.1)	5.7	6.9	6.3	(1.4)	2.8	(0.2)	0.2	-----

*Trailing twelve months

PROJECTED INCOME STATEMENT & BALANCE SHEET - ANNUAL

Chesapeake Financial Shares, Inc.

Income Statement and Balance Sheet

(Dollars in millions, except per share data)

Summary Financial Data	12/17	12/18	12/19	12/20	12/21	12/22E	12/23E
Net interest income	26.0	27.4	29.5	33.5	41.6	41.9	44.4
Non-interest income	18.1	18.6	20.3	19.6	18.9	18.8	19.3
Total net revenue	44.1	46.0	49.8	53.1	60.5	60.7	63.7
Loan loss provision	0.9	0.5	0.5	2.0	(0.4)	0.7	0.7
Non-interest expense	31.8	33.3	36.0	37.3	43.6	43.9	45.7
Income taxes & other	2.5	1.4	1.9	2.1	2.3	2.4	2.6
Zacks adjusted income before NRI	8.9	10.8	11.4	11.7	15.0	13.7	14.7
GAAP net income	8.9	10.8	11.4	11.7	15.0	13.7	14.7
Diluted EPS before NRI	1.80	2.17	2.29	2.39	3.11	2.90	3.10
Reported EPS	1.80	2.17	2.29	2.39	3.11	2.90	3.10
Dividends per share	0.43	0.46	0.49	0.50	0.53	0.56	0.56
Liquid assets	50.6	73.1	98.0	120.2	98.8	90.5	86.9
Outstandings, gross	523.7	546.0	566.7	625.0	699.7	755.9	792.8
Total assets	785.2	854.8	958.3	1,204.7	1,385.8	1,449.6	1,600.1
Core deposits	632.4	702.0	799.5	984.2	1,101.6	1,225.6	1,352.8
Purchased funds	53.1	47.2	39.6	85.3	122.4	73.9	75.1
Long-term debt	5.2	5.2	5.2	5.2	25.2	25.2	25.2
Shareholders' equity	86.8	92.7	105.4	122.7	126.1	114.5	134.6
Profitability							
Return on avg assets	1.16%	1.32%	1.22%	1.06%	1.14%	0.99%	0.97%
Return on avg equity	10.64%	12.07%	11.09%	10.27%	11.87%	12.54%	11.77%
Net interest margin	4.30%	4.10%	3.98%	3.80%	3.80%	3.43%	3.30%
Loan loss provision % avg assets	0.12%	0.06%	0.06%	0.18%	(0.03)%	0.05%	0.05%
Noninterest income % avg assets	2.34%	2.27%	2.18%	1.76%	1.44%	1.35%	1.27%
Noninterest expense % avg assets	4.11%	4.06%	3.86%	3.36%	3.32%	3.16%	3.00%
Preprovision pretax income % avg assets	1.59%	1.55%	1.48%	1.42%	1.29%	1.21%	1.18%
Tangible efficiency ratio	72%	73%	75%	72%	73%	72%	72%
Payout ratio	24%	21%	21%	21%	17%	19%	18%
Asset Quality							
Net charge-offs % avg outstandings	0.27%	0.02%	0.10%	(0.05)%	0.38%	0.04%	0.08%
Allowance % outstandings	1.17%	1.22%	1.18%	1.47%	1.17%	1.17%	1.16%
NPA's % loans + OREO	1.73%	1.93%	1.36%	1.11%	0.61%	0.62%	0.69%
Allowance % NPAs	68%	63%	86%	132%	194%	188%	167%
Liquidity & Funding							
Liquid assets % purchased funds	95%	155%	247%	141%	81%	122%	116%
Core deposits % outstandings	121%	129%	141%	157%	157%	162%	171%
Liquid assets % assets	6%	9%	10%	10%	7%	6%	5%
Outstandings % assets	67%	64%	59%	52%	50%	52%	50%
Capital Adequacy							
Total equity % assets	11.05%	10.85%	11.00%	10.18%	9.10%	7.90%	8.41%
Tangible equity % assets	11.05%	10.85%	11.00%	10.18%	9.10%	7.90%	8.41%
Tier 1 capital ratio	14.35%	15.04%	15.03%	14.03%	12.28%		
Total capital ratio	15.37%	16.08%	16.00%	15.20%	15.16%		
Parent Company Statistics							
Interest coverage	12.7X	8.2X	12.4X	41.2X	3.7X	6.5X	6.5X
Interest & dividend coverage	0.8X	0.6X	1.0X	2.0X	0.5X	0.5X	0.4X
Short-term debt coverage	Lge	Lge	Lge	Lge	Lge	Lge	Lge
Total debt coverage	2.8X	2.7X	5.0X	4.8X	0.7X	1.0X	1.0X
Double leverage	102.3%	102.6%	102.5%	102.1%	117.5%	141.5%	131.3%

PROJECTED INCOME STATEMENT & BALANCE SHEET - QUARTERLY

Chesapeake Financial Shares, Inc.

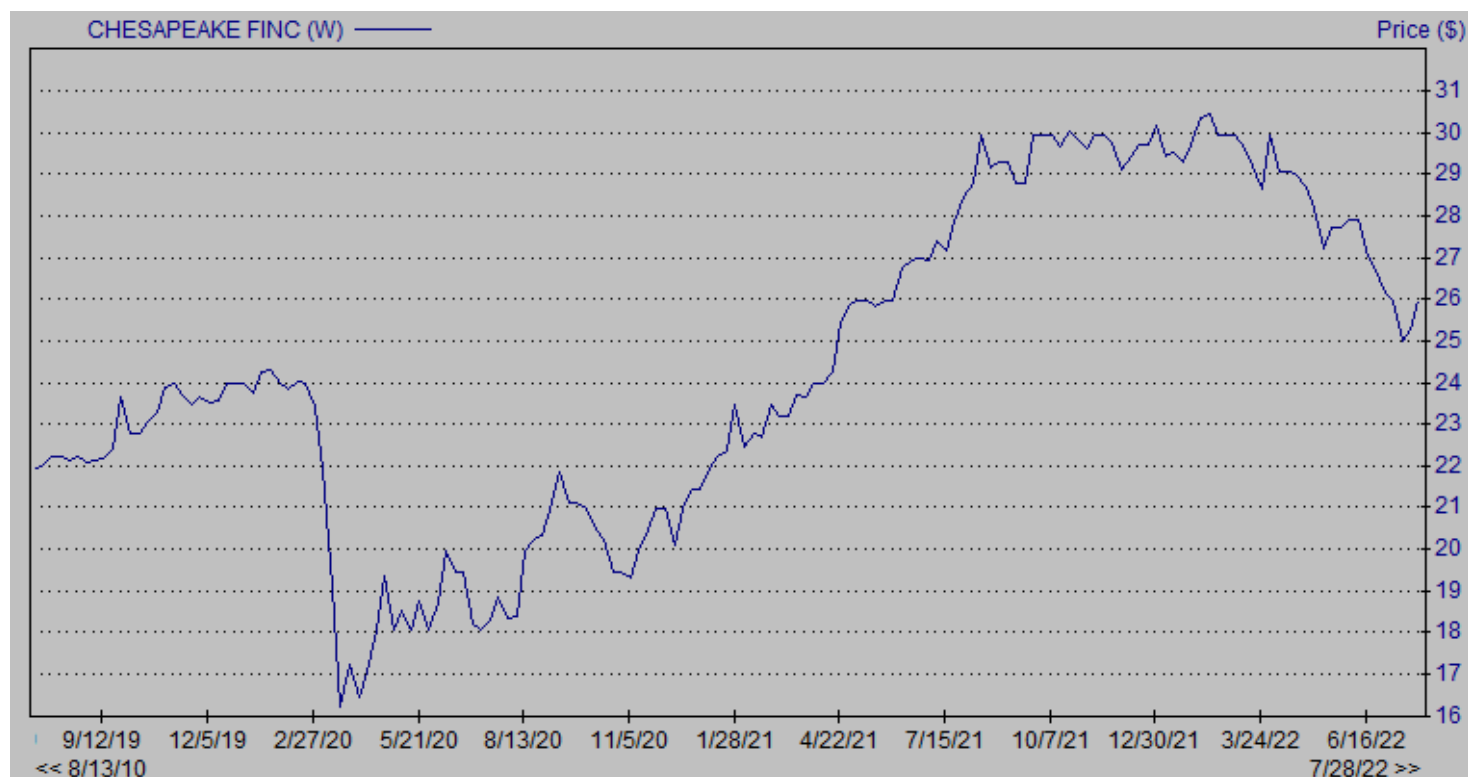
Income Statement and Balance Sheet

(Dollars in millions, except per share data)

	2021				2022			
Summary Financial Data	Q1 A	Q2 A	Q3 A	Q4 A	Q1 A	Q2 P	Q3 E	Q4 E
Net interest income	10.8	9.7	10.8	10.3	10.5	10.8	10.5	10.7
Non-interest income	4.7	5.6	4.5	4.1	5.0	5.2	4.6	4.4
Total net revenue	15.5	15.3	15.3	14.4	15.5	16.0	15.1	15.1
Loan loss provision	0.2	0.2	(0.5)	(0.2)	0.2	0.2	0.2	0.2
Non-interest expense	9.0	9.9	11.9	12.7	10.3	11.0	10.8	12.0
Income taxes & other	1.0	1.2	0.1	(0.1)	0.7	0.7	0.6	0.4
Zacks adjusted income before NRI	5.3	4.0	3.8	2.0	4.3	4.1	3.5	2.5
GAAP net income	5.3	4.0	3.8	2.0	4.3	4.1	3.5	2.5
Diluted EPS before NRI	1.08	0.82	0.78	0.42	0.90	0.86	0.74	0.54
Reported EPS	1.08	0.82	0.78	0.42	0.90	0.86	0.74	0.54
Dividends per share	0.13	0.13	0.13	0.14	0.14	0.14	0.14	0.14
Liquid assets	101.4	128.1	107.6	98.8	93.2	34.6	91.4	90.5
Outstandings, gross	648.6	637.8	651.8	699.7	719.3	733.8	744.0	755.9
Total assets	1,238.3	1,292.7	1,328.8	1,385.8	1,346.1	1,342.0	1,414.3	1,449.6
Core deposits	1,023.5	1,045.3	1,074.1	1,101.6	1,138.1	1,191.3	1,195.7	1,225.6
Purchased funds	78.5	84.4	93.2	122.4	73.0	30.3	73.6	73.9
Long-term debt	5.2	25.2	25.2	25.2	25.2	25.2	25.2	25.2
Shareholders' equity	122.0	129.7	128.0	126.1	101.0	85.2	110.6	114.5
Profitability								
Return on avg assets*	1.72%	1.25%	1.15%	0.59%	1.25%	1.21%	1.01%	0.71%
Return on avg equity *	17.21%	12.61%	11.71%	6.32%	15.05%	17.45%	13.03%	9.02%
Net interest margin*	4.21%	3.66%	3.88%	3.58%	3.53%	3.74%	3.40%	3.40%
Loan loss provision % avg assets*	0.06%	0.06%	(0.16)%	(0.07)%	0.05%	0.05%	0.05%	0.05%
Noninterest income % avg assets*	1.56%	1.76%	1.38%	1.20%	1.48%	1.54%	1.31%	1.24%
Noninterest expense % avg assets*	2.96%	3.14%	3.64%	3.73%	3.02%	3.26%	3.08%	3.35%
Preprovision pretax inc.% avg assets*	2.12%	1.69%	1.02%	0.51%	1.51%	1.50%	1.24%	0.89%
Tangible efficiency ratio	58%	68%	78%	88%	67%	69%	71%	79%
Payout ratio	12%	16%	17%	33%	16%	16%	19%	26%
Asset Quality								
Net charge-offs % avg outstandings*	(0.01)%	(0.03)%	1.55%	0.00%	(0.02)%	(0.12)%	0.05%	0.05%
Allowance % outstandings	1.46%	1.52%	1.18%	1.17%	1.18%	1.22%	1.17%	1.17%
NPA's % loans + OREO	0.99%	0.95%	0.89%	0.61%	0.57%	0.44%	0.61%	0.62%
Allowance % NPA's	145%	160%	131%	194%	208%	274%	194%	188%
Liquidity & Funding								
Liquid assets % purchased funds	129%	152%	115%	81%	128%	114%	124%	122%
Core deposits % outstandings	158%	164%	165%	157%	158%	162%	161%	162%
Liquid assets % assets	8%	10%	8%	7%	7%	3%	6%	6%
Outstandings % assets	52%	49%	49%	50%	53%	55%	53%	52%
Capital Adequacy								
Total equity % assets	9.85%	10.03	9.64%	9.10%	7.51%	6.35%	7.82%	7.90%
Tangible equity % assets	9.85%	10.03	9.64%	9.10%	7.51%	6.35%	7.82%	7.90%
Tier 1 capital ratio	14.05%	13.83%	13.34%	12.28%	12.37%			
Total capital ratio	15.19%	17.29%	16.40%	15.16%	15.23%			

*Annualized.

HISTORICAL STOCK PRICE



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