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# Zacks Small-Cap Research

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# Chesapeake Financial Shares, Inc. (CPKF-OTCQX)

## CPKF: CPKF Books Another Solid Quarter

We have chosen the $30.75 midpoint of the range of values based upon CPKF's 2022 P/E of $29.25 and forward Price/Tangible Book Value of $32.25 as our new valuation.

| | |
|---|---|
| Current Price (08/26/21) | $29.35 |
| **Valuation** | **$30.75** |

## OUTLOOK

CPKF's second quarter net earnings jumped $1.9 million, or 93%, year over year to $4.0 million, while 2021's second quarter diluted EPS soared by $0.40, or 96%, to $0.82 from $0.40 posted a year ago. This was well above our estimate, which had called for a $0.6 million increase in net earnings to $2.6 million and a $0.12 increase in diluted EPS to $0.54. The major factors behind this were a $3.1 million, or 25%, gain in net revenues, as growth in net interest income (up $1.5 million) was aided by a $1.6 million, or 39%, rise in noninterest income, as well as a $450,000 decline in the provision for loan losses. Other contributing factors included a $0.7 million, or 7%, increase in total noninterest expense, as well as $0.9 million higher income tax payments due to greater pretax earnings and a higher effective tax rate. We are raising our 2021 diluted EPS estimate by $0.20 to $2.95 from $2.75, 23% above 2020's actual diluted EPS of $2.40. Our diluted EPS estimate for 2022 remains $2.50, $0.45 or, 15%, below our 2021 estimate. The main reasons for the EPS decline in 2022 reflect the winding down of the PPP, a cutback in our estimate of cash flow income, and the absence of securities gains. Loan demand, other than for PPP loans, appears to be solid, with our estimate for loan growth in both 2021 and 2022 increased to 8% from 5%. Our loan loss provision estimate is $0.7 million in both 2021 and 2022, about 54% 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 approved a 4% quarterly dividend increase in January to $0.13 per share from $0.125 per share. 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** | **$30.00** |
| **52-Week Low** | **$19.35** |
| **One-Year Return (%)** | **46.71** |
| **Beta** | **0.84** |
| **Average Daily Volume (sh)** | **575** |
| **Shares Outstanding (mil)** | **5** |
| **Market Capitalization ($mil)** | **$142** |
| **Short Interest Ratio (days)** | **N/A** |
| **Institutional Ownership (%)** | **4** |
| **Insider Ownership (%)** | **40** |
| **Annual Cash Dividend** | **$0.52** |
| **Dividend Yield (%)** | **1.77** |
| **5-Yr. Historical Growth Rates** | |
| **Net Revenue (%)** | **7.1** |
| **Earnings Per Share (%)** | **11.9** |
| **Dividend (%)** | **5.2** |
| **P/E using TTM EPS** | **9.2** |
| **P/E using 2021 Estimate** | **9.9** |
| **P/E using 2022 Estimate** | **11.7** |
| **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 | 13.3 E | 13.0 E | 57.1 E |
| 2022 | | | | | 55.7 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 | 0.58 E | 0.47 E | 2.95 E |
| 2022 | | | | | 2.50 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.

## SECOND QUARTER

CPKF's second quarter net earnings jumped $1.9 million, or 93%, year over year to $4.0 million, while 2021's second quarter diluted EPS soared by $0.40, or 96%, to $0.82 from $0.40 posted a year ago.

This was well above our estimate, which had called for a $0.6 million increase in net earnings to $2.6 million and a $0.12 increase in diluted EPS to $0.54.

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 second quarter of $660,000, as well as higher average interest-earning assets; (2) noninterest income was $0.9 million more than we had estimated due to higher-than-expected net gains on securities sales of $730,000 and $160,000 greater trust and wealth management income; and (3) compensation expense came in $0.3 million lower than anticipated. These were offset by: (1) other miscellaneous expense that was $0.3 million more than projected and (2) income tax expense that was $0.7 million greater due to larger pretax earnings and an effective tax rate of 23.2% that was 8.2 points higher than our 15% estimate.

The major reasons for the second quarter's $1.9 million, or 93%, increase in net earnings versus the prior-year quarter were a $3.1 million, or 25%, gain in net revenues, as growth in net interest income (up $1.5 million) was aided by a $1.6 million, or 39%, rise in noninterest income, as well as a $450,000 decline in the provision for loan losses. The advance in noninterest income reflected $730,000 of securities gains, a $0.6 million increase in other miscellaneous income, a $0.3 million increase in merchant services income, and $0.2 million more trust and wealth management income. These positives were partly offset by a $0.2 million fall in mortgage banking income and a $0.1 million decline in cash flow income on lower receivables balances. Other contributing factors included a $0.7 million, or 7%, increase in total noninterest expense, largely stemming from a $0.1 million rise in compensation costs (up 1%) and a $0.6 million (up 21%) advance in other miscellaneous expense, as well as $0.9 million higher income tax payments due to greater pretax earnings and a higher effective tax rate.

We are raising our 2021 diluted EPS estimate by $0.20 to $2.95 from $2.75, 23% above 2020's actual diluted EPS of $2.40. Our diluted EPS estimate for 2022 remains $2.50, $0.45 or, 15%, 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 $4.14 million in 2021), a $1.6 million cutback in our estimate of cash flow income on reduced receivables growth prospects, and the absence of securities gains ($730,000 in 2021 to date), partly offset by a $0.7 million cut in compensation costs, reflecting a labor shortage. Details of our estimates are discussed more fully below.

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 $1.9 million remained outstanding at June 30, 2021. PPP loans that were originated in 2021 under the CAA totaled $36 million, with a remaining $32 million outstanding as of June 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 and full-year 2022, exclusive of any impact from the recognition of deferred processing fees.

The NIM will be supplemented 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 $660,000 was recognized in the second quarter. The $1.6 million balance of deferred processing fees will likely be booked into income during during the final two quarters of 2021.

For 2021, we are cutting our estimate of the loan loss provision from $0.9 million to $0.7 million, about 64% 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). For 2022, our initial estimate for the loan loss provision is also $0.7 million.

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 have increased our estimate for loan growth in both 2021 and 2022 from 5% to 8%.

We are maintaining our estimate for merchant services income at $4.0 million, with $4.3 million our estimate for 2022. We are cutting our estimate of cash management fee income to $1.5 million from $1.8 million, as customers opted for PPP loans, rather than cash flow financing. We now expect cash management to remain weak in 2022, and are cutting our estimate of cash flow fee income to $1.7 million from $3.3 million before.

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 $2.4 million in 2021 (down slightly from $2.5 million previously) and $1.8 million in 2022 (down from $2.2 million before).

On January 22, 2021 Chesapeake Financial Shares increased the quarterly dividend 4% to $0.130 per share from $0.125, effective March 1, 2021, payable on or before March 15, 2021. Notably, CPKF has increased the annual dividend payment every year for the past thirty years since 1991. This follows on the heels of a 6-for-5 stock dividend, paid October 15, 2019.

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 second quarter results more fully. Our projections are shown at the back of the report.

Net Interest Income

Net interest income increased $1.5 million, or 18%, year over year in the second quarter to $9.7 million ($1.2 million above our estimate), as a 25% increase in average interest-earning assets added to a 3.66% net interest margin, 22 basis points below the 3.88% 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 $660,000 during the quarter.

The NIM will be supplemented 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 $660,000 was recognized in the second quarter. The $1.6 million balance of deferred processing fees will likely be booked into income during during the final two quarters of 2021.

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

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

Noninterest Income

Noninterest income rose by $1.6 million, or 39%, to $5.6 million from $4.0 million in the prior-year quarter. The advance in noninterest income reflected $730,000 of securities gains, a $0.6 million increase in other miscellaneous income, a $0.3 million increase in merchant services income, and $0.2 million more trust and wealth management income. These positives were partly offset by a $0.2 million fall in mortgage banking income and a $0.1 million decline in cash flow income on lower receivables balances..

We are maintaining our estimate for merchant services income at $4.0 million, with $4.3 million our estimate for 2022. We are cutting our estimate of cash management fee income to $1.5 million from $1.8 million, as customers opted for PPP loans, rather than cash flow financing. We now expect cash management to remain weak in 2022, and are cutting our estimate of cash flow fee income to $1.7 million from $3.3 million before.

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 $2.4 million in 2021 (down slightly from $2.5 million previously) and $1.8 million in 2022 (down from $2.2 million before).

Because of these items, we have decreased our 2021 estimate for noninterest income $1.0 million to $17.3 million from $18.3 million previously, with our new estimate for 2022 at $17.1 million (down from $20.2 million before).

Loss Provision

The loan loss provision of $0.175 million was the same as our estimate. Loan loss reserves increased $1.5 million year over year to $7.7 million (1.24% of loans), which was above the first quarter's loss reserve of $7.5 million, or 1.19% of loans, as well as above the $6.2 million (1.00% of loans) posted in the year-ago quarter.

Including the loss allowance for cash flow receivables, the total loss allowance rose $1.8 million to $9.7 million (1.52% of loans plus cash flow receivables) compared with $9.4 million (1.46% of loans plus cash flow receivables) at the end of the previous quarter, and was above the $7.9 million (1.24% of loans plus cash flow receivables) at the end of the comparable year-ago quarter.

As to other asset quality measures, CPKF recorded $50,000 of net loan loss recoveries in the second quarter. This compares to $11,000 of net loan loss recoveries in the year-ago quarter and net loan loss recoveries of $256,000 for the full year in 2020.

For 2021, we are maintaining our estimate of the loan loss provision at $0.7 million, about 64% 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). For 2022, our estimate for the loan loss provision is also $0.7 million.

We project that the total loss allowance will rise to 1.51% of total loans plus receivables at yearend 2021, up from 1.47% at the end of 2020, before falling to 1.40% at yearend 2022.

Noninterest Expense

Noninterest expense rose $0.7 million, or 7%, year over year to $9.9 million (the same as our estimate), reflecting a $0.1 million rise in compensation costs (up 1%) and a $0.6 million (up 21%) advance in other miscellaneous expense.

The efficiency ratio improved, falling to 75.4% from 75.8% in the year-ago quarter, but was worse than the first quarter's 68.3%.

We project that compensation costs will increase from $22.7 million actual in 2020 to $23.3 million ($24.0 million before) in 2021 and $24.5 million ($25.2 million before) in 2022 compared to $22.7 million actual in 2020. Our estimate of noncompensation costs is $16.0 million ($15.2 million before) for 2021 and $16.2 million ($15.6 million before) for 2022, compared to $14.7 million actual in 2020. Our estimate of the efficiency ratio is 69.8% in 2021 and 73.1% in 2022, compared to 72.0% actual in 2020.

Income Taxes

The Company had a 23.2% effective tax rate in the second quarter that was almost double the 11.8% tax rate in the year-ago quarter. This compares to our estimate of an effective tax rate of 15.0%.

CPKF will be reversing part of the second quarter's overaccrual of taxes in the third and fourth quarters, for which we are using an 8.6% effective tax rate. For the year, we are using an estimated 16.0% tax rate in 2021 and 15.0% in 2022. This compares to a full-year effective tax rate of 14.8% in 2020.

Net Income

CPKF's second quarter net earnings jumped $1.9 million, or 93%, year over year to $4.0 million, while 2021's second quarter diluted EPS soared by $0.40, or 96%, to $0.82 from $0.40 posted a year ago.

This was well above our estimate, which had called for a $0.6 million increase in net earnings to $2.6 million and a $0.12 increase in diluted EPS to $0.54.

Profitability
CPKF posted a 12.6% ROE and 1.25% ROA for the second quarter of 2021, compared to 7.5% and 0.79%, respectively, in the prior-year quarter.

Loans and Asset Quality
Gross loans decreased $3 million, or less than 1%, year over year, and fell $11 million, or 2%, sequentially to $631 million, reflecting a decline in PPP loans.

By category, 1-4 family gained $7.4 million, or 6%, to $142 million; construction and land development loans rose $5.8 million, or 12%, to $53 million; and commercial real estate loans increased $5.3 million, or 2%, to $258 million. Negatively, commercial and industrial loans dropped $30.1 million, or 19%, to $129 million reflecting a decline in PPP loans; other loans fell $0.4 million, or 1%, to $32 million; and consumer loans decreased $0.2 million, or 2%, to $8 million. Cash management receivables were flat at $18 million.

Loan demand, other than for PPP loans, appears to be solid, and we have increased our estimate for loan growth in both 2021 and 2022 from 5% to 8%.

Asset quality measures improved during the second quarter. Total nonperforming assets fell $0.4 million to $6.1 million from $6.5 million sequentially. Nonaccrual loans decreased by $0.1 million to $2.3 million from $2.4 million, while other real estate owned decreased $1.3 million to $2.7 million. Restructured loans increased to $1.0 million from zero. In total, nonperforming assets (NPAs), including troubled debt restructurings that are current in payments, decreased 4 basis points to 0.95% of outstandings + OREO at June 30, 2021 from 0.99% of outstandings + OREO at March 31, 2021, and fell 23 basis points year over year from 1.18%.

The loss allowance as a percent of nonperforming assets increased to 160% from 145% sequentially, as improvement in nonperforming assets combined with an increase in the loss reserve for loans plus cash flow receivables.

Liquidity and Funding
Cash and equivalents increased by $5 million to $54 million at the end of the second quarter, while the securities portfolio rose $62 million to $543 million. By category, the municipal securities portfolio increased $35 million to $332 million, the private-label mortgage securities portfolio increased $1 million to $90 million, US government-related securities gained $22 million to $74, and asset-backed securities (primarily student loans under the FFELP program) rose $4 million to $47 million.

On a relative basis, municipal securities were 61% of the entire available-for-sale securities portfolio, the private-label mortgage securities portfolio was 17%, US government-related securities were 14%, and asset-backed securities and other were 8%.

CPKF's liquidity ratios improved compared to the previous quarter. At June 30, 2021, liquid assets represented 10% of total assets (8% at the end of the first quarter) and covered purchased funds by 152% (up from 129%), while loans plus receivables accounted for 49% of total assets (52% at March 31, 2021).

Core deposits rose $22 million sequentially to $1,045 million and funded 164% of loans and receivables.

Capital Adequacy and Dividends
The Company's capital adequacy ratios were mixed during the second quarter, as growth in risk-weighted assets outpaced growth in Tier 1 capital. The Tier 1 capital ratio fell 22 basis points sequentially to 13.83% at the end of 2021's second quarter from 14.05% at March 31, 2021, while the Total capital ratio expanded 210 basis points, rising to 17.29% from 15.19%, reflecting the opportunistic sale of $20 million of subordinated debt during the second quarter, thereby inncreasing Total capital.

Total shareholders' equity increased $7.7 million during the second quarter, as a $4.6 million gain in accumulated other comprehensive income plus a $3.3 million advance in retained earnings more than offset a negative $0.2 million in capital changes.

Reflecting these factors plus a 6,000 increase in common shares outstanding, tangible book value per share rose during the second quarter, by $1.56 per share to $26.78 from $25.22. The total equity to total assets ratio strengthened, increasing by 18 basis points to 10.03% from 9.85%, as growth in common shareholders' equity ouptpaced growth in total assets.

## OVERVIEW

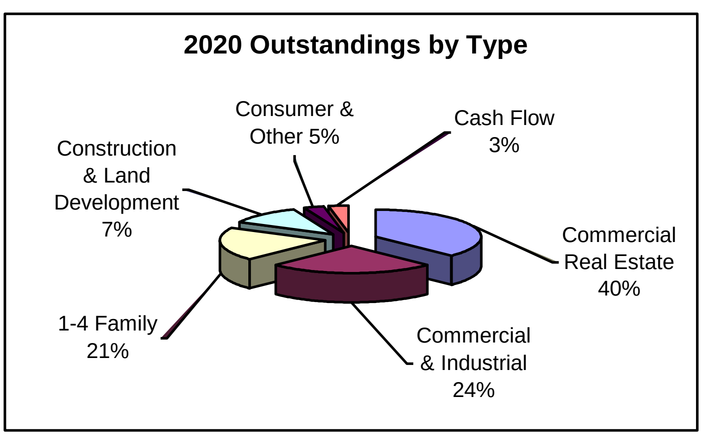
Chesapeake Financial Shares, Inc. (CPKF or the Company) is a financial holding company headquartered in Kilmarnock, Virginia, with $1,293 million in total assets at June 30, 2021. CPKF is predominantly a small business lender with 16 branch offices that serve customers in the eastern region of Virginia 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.

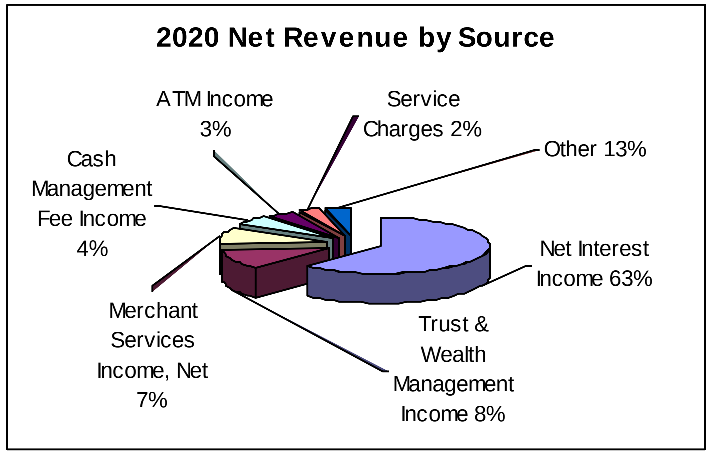
The Cash Flow program, which provides an attractive financing option to growing businesses, involves the purchase of the client company's accounts receivables. The Cash Flow program is currently offered in the Eastern half of the United States and had 60 customers at the end of 2020.

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 36.5% year to date, a better performance than the 19.0% price increase for the S&P 500, as well as the 34.0% 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 11.7X for 2022, CPKF's target price based upon our 2022 EPS estimate is about $29.25.

Turning to Price/Tangible Book Value, CPKF is currently valued at 1.09X. Assuming CPKF trades at the median 1.13X 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 $32.25, which compares to CPKF's current book value of $26.78.

We have chosen the $30.75 midpoint of the range of values based upon CPKF's 2022 P/E of $29.25 and forward Price/Tangible Book Value of $32.25 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** | **36.5** | **9.2** | **9.9** | **11.7** | **12.7** | **10.8** | **1.27** | **1.16** | **1.8** |
| S&P 500 | **19.0** | **29.5** | **23.5** | **20.8** | **-----** | **-----** | **-----** | **-----** | **1.3** |
| **Median** | **34.0** | **10.1** | **9.9** | **11.7** | **12.3** | **9.5** | **1.18** | **1.00** | **2.4** |
| Average | 32.3 | 9.2 | 9.1 | 10.7 | 12.7 | 10.3 | 1.2 | 1.0 | 2.1 |
| High | 90.6 | 21.2 | 22.2 | 22.4 | 25.7 | 20.3 | 2.2 | 2.1 | 4.7 |
| Low | (2.1) | 4.7 | 5.4 | 8.0 | 4.6 | 2.5 | 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 | 39.8 | 38.6 |
| Non-interest income | 14.7 | 18.1 | 18.6 | 20.3 | 19.6 | 17.3 | 17.1 |
| Total net revenue | 39.1 | 44.1 | 46.0 | 49.8 | 53.1 | 57.1 | 55.7 |
| Loan loss provision | 0.5 | 0.9 | 0.5 | 0.5 | 2.0 | 0.7 | 0.7 |
| Non-interest expense | 30.4 | 31.8 | 33.3 | 36.0 | 37.3 | 39.3 | 40.7 |
| Income taxes & other | 1.2 | 2.5 | 1.4 | 1.9 | 2.1 | 2.8 | 2.2 |
| Zacks adjusted income before NRI | 7.0 | 8.9 | 10.8 | 11.4 | 11.7 | 14.3 | 12.1 |
| GAAP net income | 7.0 | 8.9 | 10.8 | 11.4 | 11.7 | 14.3 | 12.1 |
| Diluted EPS before NRI | 1.42 | 1.80 | 2.17 | 2.29 | 2.40 | 2.95 | 2.50 |
| Reported EPS | 1.42 | 1.80 | 2.17 | 2.29 | 2.40 | 2.95 | 2.50 |
| Dividends per share | 0.41 | 0.43 | 0.46 | 0.49 | 0.50 | 0.52 | 0.52 |
| | | | | | | | |
| Liquid assets | 40.6 | 50.6 | 73.1 | 98.0 | 120.2 | 124.3 | 119.4 |
| Outstandings, gross | 481.4 | 523.7 | 546.0 | 566.7 | 625.0 | 629.2 | 681.1 |
| Total assets | 720.8 | 785.2 | 854.8 | 958.3 | 1,204.7 | 1,297.5 | 1,377.2 |
| Core deposits | 522.3 | 632.4 | 702.0 | 799.5 | 984.2 | 1,042.6 | 1,106.6 |
| Purchased funds | 97.4 | 53.1 | 47.2 | 39.6 | 85.3 | 85.1 | 86.5 |
| 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 | 133.5 | 143.1 |
| | | | | | | | |
| **Profitability** | | | | | | | |
| Return on avg assets | 0.99% | 1.16% | 1.32% | 1.22% | 1.06% | 1.13% | 0.91% |
| Return on avg equity | 8.89% | 10.64% | 12.07% | 11.09% | 10.27% | 11.19% | 8.76% |
| Net interest margin | 4.38% | 4.30% | 4.10% | 3.98% | 3.80% | 3.62% | 3.30% |
| Loan loss provision % avg assets | 0.08% | 0.12% | 0.06% | 0.06% | 0.18% | 0.06% | 0.05% |
| Noninterest income % avg assets | 2.06% | 2.34% | 2.27% | 2.18% | 1.76% | 1.36% | 1.28% |
| Noninterest expense % avg assets | 4.28% | 4.11% | 4.06% | 3.86% | 3.36% | 3.10% | 3.05% |
| Preprovision pretax income % avg assets | 1.23% | 1.59% | 1.55% | 1.48% | 1.42% | 1.40% | 1.12% |
| Tangible efficiency ratio | 78% | 72% | 73% | 75% | 72% | 70% | 73% |
| Payout ratio | 29% | 24% | 21% | 21% | 21% | 18% | 21% |
| | | | | | | | |
| **Asset Quality** | | | | | | | |
| Net charge-offs % avg outstandings | 0.18% | 0.27% | 0.02% | 0.10% | (0.05)% | 0.08% | 0.12% |
| Allowance % outstandings | 1.34% | 1.17% | 1.22% | 1.18% | 1.47% | 1.51% | 1.40% |
| NPAs % loans + OREO | 2.21% | 1.73% | 1.93% | 1.36% | 1.11% | 1.02% | 1.06% |
| Allowance % NPAs | 60% | 68% | 63% | 86% | 132% | 147% | 131% |
| | | | | | | | |
| **Liquidity & Funding** | | | | | | | |
| Liquid assets % purchased funds | 42% | 95% | 155% | 247% | 141% | 146% | 138% |
| Core deposits % outstandings | 108% | 121% | 129% | 141% | 157% | 166% | 162% |
| Liquid assets % assets | 6% | 6% | 9% | 10% | 10% | 10% | 9% |
| Outstandings % assets | 67% | 67% | 64% | 59% | 52% | 48% | 49% |
| | | | | | | | |
| **Capital Adequacy** | | | | | | | |
| Total equity % assets | 10.81% | 11.05% | 10.85% | 11.00% | 10.18% | 10.29% | 10.39% |
| Tangible equity % assets | 10.81% | 11.05% | 10.85% | 11.00% | 10.18% | 10.29% | 10.39% |
| 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 | 1.9X | 1.9X |
| 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% | 104.5% | 106.0% |

# Chesapeake Financial Shares, Inc.

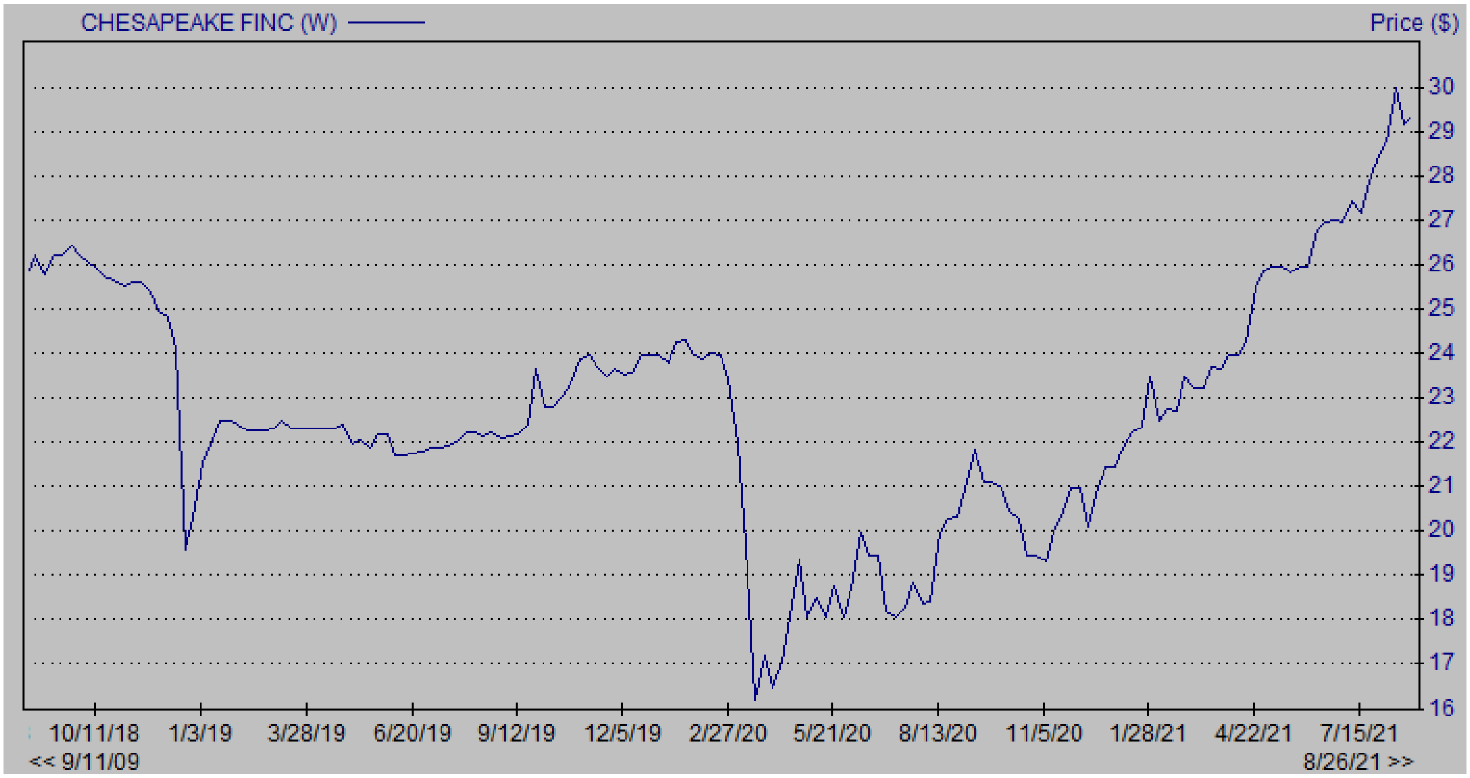
**Income Statement and Balance Sheet**

*(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 E** | **Q4 E** |
| Net interest income | 7.6 | 8.2 | 8.4 | 9.3 | 10.8 | 9.7 | 9.6 | 9.7 |
| Non-interest income | 5.7 | 4.0 | 5.3 | 4.6 | 4.7 | 5.6 | 3.7 | 3.3 |
| Total net revenue | 13.3 | 12.2 | 13.7 | 13.9 | 15.5 | 15.3 | 13.3 | 13.0 |
| Loan loss provision | 0.5 | 0.6 | 0.6 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Non-interest expense | 8.8 | 9.3 | 9.1 | 10.2 | 9.0 | 9.9 | 10.0 | 10.4 |
| Income taxes & other | 0.6 | 0.2 | 0.6 | 0.6 | 1.0 | 1.2 | 0.3 | 0.1 |
| Zacks adjusted income before NRI | 3.4 | 2.1 | 3.4 | 2.9 | 5.3 | 4.0 | 2.8 | 2.3 |
| GAAP net income | 3.4 | 2.1 | 3.4 | 2.9 | 5.3 | 4.0 | 2.8 | 2.3 |
| Diluted EPS before NRI | 0.68 | 0.42 | 0.69 | 0.61 | 1.08 | 0.82 | 0.58 | 0.47 |
| Reported EPS | 0.68 | 0.42 | 0.69 | 0.61 | 1.08 | 0.82 | 0.58 | 0.47 |
| Dividends per share | 0.13 | 0.13 | 0.13 | 0.13 | 0.13 | 0.13 | 0.13 | 0.13 |
| | | | | | | | | |
| Liquid assets | 83.1 | 96.0 | 114.1 | 120.2 | 101.4 | 128.1 | 125.5 | 124.3 |
| Outstandings, gross | 563.2 | 639.3 | 639.6 | 625.0 | 648.6 | 637.8 | 633.5 | 629.2 |
| Total assets | 951.4 | 1,114.7 | 1,172.2 | 1,204.7 | 1,238.3 | 1,292.7 | 1,295.1 | 1,297.5 |
| Core deposits | 796.4 | 901.7 | 955.0 | 984.2 | 1,023.5 | 1,045.3 | 1,044.0 | 1,042.6 |
| Purchased funds | 37.6 | 84.6 | 84.0 | 85.3 | 78.5 | 84.4 | 84.8 | 85.1 |
| 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 | 131.9 | 133.5 |
| | | | | | | | | |
| **Profitability** | | | | | | | | |
| Return on avg assets* | 1.41% | 0.79% | 1.18% | 0.99% | 1.72% | 1.25% | 0.87% | 0.70% |
| Return on avg equity * | 12.81% | 7.52% | 11.76% | 9.84% | 17.21% | 12.61% | 8.63% | 6.81% |
| Net interest margin* | 3.79% | 3.88% | 3.73% | 3.83% | 4.21% | 3.66% | 3.30% | 3.30% |
| Loan loss provision % avg assets* | 0.22% | 0.24% | 0.22% | 0.06% | 0.06% | 0.06% | 0.05% | 0.05% |
| Noninterest income % avg assets* | 2.37% | 1.55% | 1.85% | 1.55% | 1.56% | 1.76% | 1.14% | 1.01% |
| Noninterest expense % avg assets* | 3.68% | 3.58% | 3.17% | 3.44% | 2.96% | 3.14% | 3.09% | 3.19% |
| Preprovision pretax inc.% avg assets* | 1.88% | 1.14% | 1.60% | 1.25% | 2.12% | 1.69% | 1.01% | 0.82% |
| Tangible efficiency ratio | 73% | 76% | 66% | 73% | 58% | 68% | 75% | 80% |
| Payout ratio | 18% | 30% | 18% | 21% | 12% | 16% | 22% | 28% |
| | | | | | | | | |
| **Asset Quality** | | | | | | | | |
| Net charge-offs % avg outstandings* | 0.01% | (0.07)% | (0.47)% | 0.29% | (0.01)% | (0.03)% | 0.19% | 0.19% |
| Allowance % outstandings | 1.28% | 1.24% | 1.45% | 1.47% | 1.46% | 1.52% | 1.52% | 1.51% |
| NPAs % loans + OREO | 1.37% | 1.18% | 1.30% | 1.11% | 0.99% | 0.95% | 0.99% | 1.02% |
| Allowance % NPAs | 93% | 104% | 91% | 104% | 145% | 160% | 153% | 147% |
| | | | | | | | | |
| **Liquidity & Funding** | | | | | | | | |
| Liquid assets % purchased funds | 221% | 113% | 136% | 136% | 129% | 152% | 148% | 146% |
| Core deposits % outstandings | 141% | 141% | 149% | 154% | 158% | 164% | 165% | 166% |
| Liquid assets % assets | 9% | 9% | 10% | 10% | 8% | 10% | 10% | 10% |
| 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% | 10.18% | 10.29% |
| Tangible equity % assets | 11.03% | 10.16% | 9.98% | 10.18% | 9.85% | 10.03% | 10.18% | 10.29% |
| Tier 1 capital ratio | 15.05% | 14.51% | 14.20% | 14.03% | 14.05% | 13.83% | | |
| Total capital ratio | 16.07% | 15.58% | 15.42% | 15.20% | 15.19% | 17.29% | | |

*Annualized.

## HISTORICAL STOCK PRICE



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