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Zacks Small-Cap Research

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Chesapeake Financial Shares, Inc. (CPKF-OTCQX)

CPKF: Record Earnings in 2022

We have chosen the $32.00 midpoint of the range of values based upon CPKF's 2022 P/E of $31.00 and forward Price/Tangible Book Value of $33.00 as our new valuation.

Current Price (02/17/22)	$30.00
Valuation	**$32.00**

OUTLOOK

CPKF's fourth quarter net earnings decreased $0.9 million, or 32%, year over year to $2.0 million, while 2021's fourth quarter diluted EPS fell by $0.19, or 31%, to $0.42 from $0.61 posted a year ago. This was slightly below our estimate, which had called for a $0.7 million decrease in net earnings to $2.3 million and a $0.14 decline in diluted EPS to $0.47.
The major reasons for the fourth quarter's decrease versus the prior-year quarter were a $0.5 million gain in net revenues, a $0.4 million decline in the provision for loan losses, and income tax payments that were $0.6 million lower due to a reduced effective tax rate, which were partly offset by a $2.4 million increase in total noninterest expense. Our diluted EPS estimate for 2022 remains the same at $2.70, or 13% below 2021's diluted EPS of $3.11. The main reasons for the EPS decline in 2022 reflect the winding down of the PPP, the absence of securities gains, a loss provision compared to a reversal in 2021, and a drop in mortgage banking income, partly offset by a strong turnaround in the cash management business, including a solid gain in fee income and a decrease in the cash management loss provision. Loan demand appears to be solid, with our estimate for loan growth in 2022 at 8%. Our estimate for the loan loss provision remains $0.7 million, up from $2021's loan loss reversal (credit) of $0.4 million in 2021, but down from 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. Factors adding to CPKF's expense burden include several new hires, greater IT expense for CPKF's new on-line banking platform, and higher depreciation from the opening of a new tech center. CPKF increased the dividend twice in 2021 and has increased its 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	**$31.00**
52-Week Low	**$22.75**
One-Year Return (%)	**33.73**
Beta	**0.77**
Average Daily Volume (sh)	**640**
Shares Outstanding (mil)	**5**
Market Capitalization ($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 (%)	**9.1**
Earnings Per Share (%)	**16.9**
Dividend (%)	**5.4**
P/E using TTM EPS	**9.6**
P/E using 2021 Actual	**9.6**
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	14.4 A	60.5 A
2022					59.5 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	0.42 A	3.11 A
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.

FOURTH QUARTER

CPKF's fourth quarter net earnings decreased $0.9 million, or 32%, year over year to $2.0 million, while 2021's fourth quarter diluted EPS fell by $0.19, or 31%, to $0.42 from $0.61 posted a year ago.

This was slightly below our estimate, which had called for a $0.7 million decrease in net earnings to $2.3 million and a $0.14 decline in diluted EPS to $0.47.

The main factors behind the difference between actual results and our estimate were: (1) net interest income was $0.6 million higher than our estimate due to a larger-than expected net interest margin of 3.58% (versus our 3.25% estimate), as well as higher average interest-earning assets; (2) the provision for loan losses swung a positive $0.4 million to a credit of $225,000 (i.e., a reversal of the loss provision) from an estimated charge (provision) of $175,000, as credit quality was better than anticipated; (3) income tax expense was $0.6 million less than our estimate due to an effective tax credit of 2.3% that was 22.3 points lower than our 20.0% effective tax rate estimate, as CPKF trued up the tax accrual account for the year; and (4) other miscellaneous expense was $0.3 million lower than projected. These positives were more than offset by: (1) noninterest income that was $0.8 million, or 17%, less than we had estimated due to worse-than-expected contributions from most segments, except the cash management and trust and wealth management segments; (2) compensation expense was $0.5 million higher than our estimate stemming from one-time bonus payments in recognition of 2021's record profitability; (3) occupancy expense was $0.5 million above our estimate due to a number of one-time costs; and (4) the provision for cash management losses of $0.75 million came in $0.4 million above our $0.35 million estimate, due to exceptional receivables growth during the fourth quarter (up 44% sequentially).

The major reasons for the fourth quarter's $0.9 million, or 32%, decrease in net earnings versus the prior-year quarter were a $0.5 million, or 3%, gain in net revenues, as growth in net interest income (up $1.0 million, or 11%) was partly offset by a $0.5 million, or 12%, decline in other noninterest income. The decrease in noninterest income primarily reflected a $0.3 million drop in mortgage banking income on weaker activity as well as a $0.2 million fall in net merchant services income. In addition, earnings benefitted from a $0.4 million decline in the provision for loan losses to a credit (reversal) of $225,000 from a charge (provision) of $175,000 in the prior year. Moreover, income tax payments were $0.6 million lower due to a reduced effective tax rate that was 19.3 points less than a year ago. These positives were partly offset by a $2.4 million, or 24%, increase in total noninterest expense, largely stemming from a $0.5 million rise in compensation costs (up 8%), a $0.6 million advance in the provision for cash management losses, a $0.9 million jump in other miscellaneous expense (up 33%), and a $0.4 million (49%) rise in occupancy costs.

For the year, CPKF posted record net income of $15.0 million, or $3.11 per diluted share, up from the $11.7 million, or $2.39 per diluted share, posted in 2020.

Primary contributors to this result were a $7.4 million, or 14%, gain in net revenues from an $8.0 million, or 24%, rise in net interest income (including recognition of $4.13 million in PPP fee income), partly offset by a $0.6 million, or 12%, decline in noninterest income, as well as a $2.4 million positive swing in the provision for loan losses. This was partly offset by a $6.2 million, or 17%, increase in total noninterest expense, largely the result of a $3.0 million advance in other miscellaneous expense (up 26%), a $1.6 million jump in the provision for cash management losses stemming from growth in receivables and the charge-off of one $2.3 million credit, a $1.0 million rise in compensation costs (up 5%), and a $0.6 million increase (up 20%) in occupancy costs. In addition, income taxes increased by $0.3 million on larger pretax earnings, partially offset by a lower effective tax rate of 13.3% compared to 14.8% in 2020.

Our diluted EPS estimate for 2022 remains the same at $2.70, or 13% below 2021's diluted EPS of $3.11. 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), a loss provision of $0.7 million (compared to a credit of $0.4 million in 2021), and a $0.7 million drop in mortgage banking income, partly offset by a strong turnaround in the cash management business, including a $1.4 million gain in fee income (up 68%) and a $1.6 million decrease in the cash management loss provision.

CPKF 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 Appropriations 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 less than $58,000 remained outstanding at December 31, 2021. PPP loans that were originated in 2021 under the CAA totaled $36 million, with a remaining $2.7 million outstanding as of December 31, 2021.

The PPP loans had countervailing impacts on the CPKF's net interest margin. First, the 1% annual interest rate is lower than is typical for CPKF loans, which reduced the NIM. However, PPP processing fees, amortized over the life of the loan, added to the NIM. Moreover, when a PPP loan is forgiven, any deferred processing fee was also added to the NIM. We have estimated a net interest margin of 3.30% for full-year 2022, noting that remaining PPP income will total only about $100,000 in 2022.

The NIM was 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 was booked into income in 2021's fourth quarter ($0.3 million) and 2022's first quarter ($0.1 million).

For 2022, our estimate for the loan loss provision remains $0.7 million, up from $2021's loan loss reversal (credit) of $0.4 million in 2021, but down from 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).

The provision for cash management losses, a separate line item listed under other noninterest expense, is expected to decline to about $240,000 in 2022, down $1.6 million from 2021's $1.8 million, which reflected strong growth in receivables during the fourth quarter, as well as the charge-off of one $2.3 million credit.

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 operations, marketing, and merchant card processing, and will add to depreciation expense beginning in 2021's third quarter.

Loan demand appears to be solid, and we are maintaining our estimate of loan growth in 2022 at 8%.

We are continuing our estimate of merchant services income at $4.3 million in 2022, though a recently added ISO relationship may provide higher growth going forward. We are sharply increasing our estimate of cash management income by $1.4 million (up 68%), as we expect strong receivables growth. This reflects the addition of new clients, as well as growth in existing client credit lines, following the stoppage of the PPP program.

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 estimate for mortgage banking income is $2.2 million in 2022, down from $2.8 million actual in 2021, reflecting reduced activity due to the impact of higher mortgage rates.

Chesapeake Financial Shares increased the quarterly dividend twice in 2021. On October 14, 2021, the Board of Directors raised the dividend by 8% to $0.14 per share from $0.13 per share, paid 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 fourth quarter results more fully. Our projections are shown at the back of the report.

<u>Net Interest Income</u>

Net interest income increased $1.0 million, or 11%, year over year in the fourth quarter to $10.3 million ($0.6 million above our estimate), as a 21% increase in average interest-earning assets added to a 3.58% net interest margin, 25 basis points below the 3.83% earned in the year-ago quarter, but above our 3.25% 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 $306,000 during the quarter.

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 was booked into income in 2021's fourth quarter ($0.3 million) and 2022's first quarter ($0.1 million).

We have estimated a net interest margin of 3.30% for full-year 2022, noting that remaining PPP income will total only about $100,000 in 2022.

We note CPKF's balance sheet was asset sensitive at the end of the fourth 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 fell by $0.5 million, or 12%, to $4.1 million from $5.6 million in the prior-year quarter. The decrease in noninterest income primarily reflected a $0.3 million drop in mortgage banking income on weaker activity as well as a $0.2 million fall in net merchant services income.

We are continuing our estimate of merchant services income at $4.3 million in 2022, though a recently added ISO relationship may provide higher growth going forward. We are sharply increasing our estimate of cash management income by $1.4 million (up 68%), as we expect strong receivables growth. This reflects the addition of new clients, as well as growth in existing client credit lines, following the stoppage of the PPP program.

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 estimate for mortgage banking income is $2.2 million in 2022, down from $2.8 million actual in 2021, reflecting reduced activity due to the impact of higher mortgage rates.

Largely because of these items, we have increased our 2022 estimate for noninterest income by $0.9 million to $19.2 million from $18.3 million previously.

Loss Provision
The provision for loan losses benefitted from a $0.4 million improvement during the fourth quarter to a credit (reversal) of $225,000 from a charge (provision) of $175,000 in the prior-year quarter. Loan loss reserves decreased $0.5 million year over year to $6.8 million (1.01% of loans), which was below the third quarter's loss reserve of $7.0 million, or 1.11% of loans, as well as the $7.3 million (1.20% of loans) posted in the year-ago quarter.

Including the loss allowance for cash management receivables, the total loss allowance increased $0.5 million to $8.2 million (1.17% of loans plus cash management receivables) compared with $7.7 million (1.18% of loans plus cash management receivables) at the end of the previous quarter, and was below the $9.2 million (1.47% of loans plus cash management receivables) at the end of the comparable year-ago quarter.

As to other asset quality measures, CPKF recorded $14,000 of net charge-offs in the fourth quarter. This compares to $487,000 of net charge-offs in the year-ago quarter and net charge-offs of $86,000 for the full year in 2021. In addition, during the third quarter CPKF reported $2.4 million of net charge-offs in its cash management operation (compared to zero a year ago), stemming from the bankruptcy of one $2.3 million credit.

For 2022, our estimate for the loan loss provision remains $0.7 million, up from $2021's loan loss reversal (credit) of $0.4 million in 2021, but down from 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)

We project that the total loss allowance will drop to 1.10% of total loans plus receivables at yearend 2022, down from 1.17% actual at the end of 2021.

Noninterest Expense
There was a $2.4 million, or 24%, increase in total noninterest expense, largely stemming from a $0.5 million rise in compensation costs (up 8%), a $0.6 million advance in the provision for cash management losses, a $0.9 million jump in other miscellaneous expense (up 33%), and a $0.4 million (49%) rise in occupancy costs.

Reflecting higher expenses, the efficiency ratio deteriorated, increasing to 87.9% from 73.4% in the year-ago quarter, and was worse than the third quarter's 78.1%.

We project that compensation costs will increase from $23.8 million actual in 2021 and $26.1 million in 2022, reflecting a number of new hires.

We are maintaining our estimate of noncompensation costs in 2022 at $17.4 million, down $2.4 million from 2021's $19.8 million actual. This decrease primarily reflects a $1.6 million reduction in the provision for cash management losses, as well as a $0.5 million decrease in occupancy costs due to the absense of a number of one-time expenses as occurred in 2021. Our estimate of the efficiency ratio is and 73.2% in 2022, compared to 72.9% actual in 2021.

Income Taxes

The Company had a 2.3% effective tax credit in the fourth quarter as CPKF trued up the tax accrual account for the year. This compares to a 17.0% tax rate in the year-ago quarter and our estimate of an effective tax rate of 20.0%.

For the year, we are estimating an effective tax rate 15.0% in 2022. This compares to a full-year effective tax rate of 13.3% in 2021.

Net Income

CPKF's fourth quarter net earnings decreased $0.9 million, or 32%, year over year to $2.0 million, while 2021's fourth quarter diluted EPS fell by $0.19, or 31%, to $0.42 from $0.61 posted a year ago.

This was slightly below our estimate, which had called for a $0.7 million decrease in net earnings to $2.3 million and a $0.14 decline in diluted EPS to $0.47.

Profitability

CPKF posted a 6.3% ROE and 0.59% ROA for the fourth quarter of 2021, compared to 9.8% and 0.99%, respectively, in the prior-year quarter.

Loans and Asset Quality

Gross loans increased $66 million, or 11%, year over year, and rose $39 million, or 6%, sequentially to $672 million, reflecting solid loan growth.

By category, commercial real estate loans increased $27.6 million, or 10%, to $295 million; construction and land development loans rose $8.8 million, or 15%, to $68 million; cash management receivables gained $8.5 million, or 44%, to $28 million; commercial and industrial loans rose $6.3 million, or 6%, to $114 million; 1-4 family gained $4.3 million, or 3%, to $155 million; Negatively, other loans dropped $5.1 million, or 14%, to $32 million and consumer loans decreased $1.9 million, or 19%, to $8 million.

Loan demand appears to be solid, and we are maintaining our estimate for loan growth in 2022 at 8%.

Asset quality measures improved modestly during the fourth quarter. Total nonperforming assets fell $0.7 million to $5.1 million from $5.8 million sequentially. Nonaccrual loans decreased by $0.1 million to $2.1 million from $2.2 million, while other real estate owned ecreased $1.4 million to $1.3 million. Restructured loans grew $0.8 million to $1.8 million. In total, nonperforming assets (NPAs), including troubled debt restructurings that are current in payments, decreased 16 basis points to 0.73% of outstandings + OREO at December 31, 2021 from 0.89% of outstandings + OREO at September 30, 2021, and fell 38 basis points year over year from 1.11%.

The loss allowance as a percent of nonperforming assets increased to 161% from 131% sequentially, as improvement in nonperforming assets was aided by an increase in the loss reserve for loans plus cash management receivables.

Liquidity and Funding
Cash and equivalents decreased by $7 million to $21 million at the end of the fourth quarter, while the securities portfolio rose $16 million to $601 million. By category, the private-label mortgage securities portfolio increased $10 million to $99 million, the municipal securities portfolio increased $7 million to $374 million, US government-related securities fell $2 million to $78, and asset-backed securities (primarily student loans under the FFELP program) were flat at $50 million.

On a relative basis, municipal securities were 62% of the entire available-for-sale securities portfolio, the private-label mortgage securities portfolio was 17%, US government-related securities were 13%, and asset-backed securities and other were 8%.

CPKF's liquidity ratios worsened compared to the previous quarter. At December 31, 2021, liquid assets represented 7% of total assets (8% at the end of the third quarter) and covered purchased funds by 81% (down from 115%), while loans plus receivables accounted for 50% of total assets (49% at September 30, 2021).

Core deposits rose $28 million sequentially to $1,102 million and funded 157% of loans and receivables.

Capital Adequacy and Dividends
The Company's capital adequacy ratios declined during the fourth quarter, as growth in risk-weighted assets outpaced growth in Tier 1 capital. The Tier 1 capital ratio fell 106 basis points sequentially to 12.28% at the end of 2021's fourth quarter from 13.34% at September 30, 2021, while the Total capital ratio decreased 124 basis points, dropping to 15.16% from 16.40%.

Total shareholders' equity decreased $1.9 million during the fourth quarter, as a $1.3 million advance in retained earnings was more than offset by a $0.9 million decline in accumulated other comprehensive income plus a negative $2.3 million in capital changes.

Reflecting these factors plus an 81,000 decrease in common shares outstanding, tangible book value per share increased during the fourth quarter, by $0.05 per share to $26.67 from $26.62. The total equity to total assets ratio worsened, decreasing by 54 basis points to 9.10% from 9.64%, as growth in total assets ouptpaced growth in common shareholders' equity.

OVERVIEW

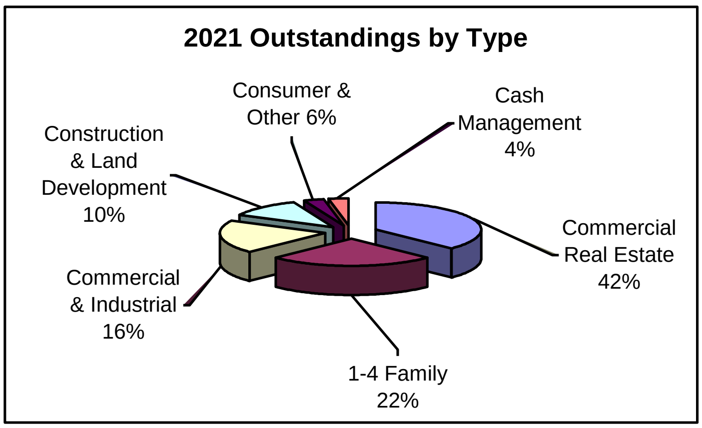
Chesapeake Financial Shares, Inc. (CPKF or the Company) is a financial holding company headquartered in Kilmarnock, Virginia, with $1,386 million in total assets at December 31, 2021. CPKF is predominantly a small business lender with 16 branch offices that serve customers in the eastern region of Virginia 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 $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).



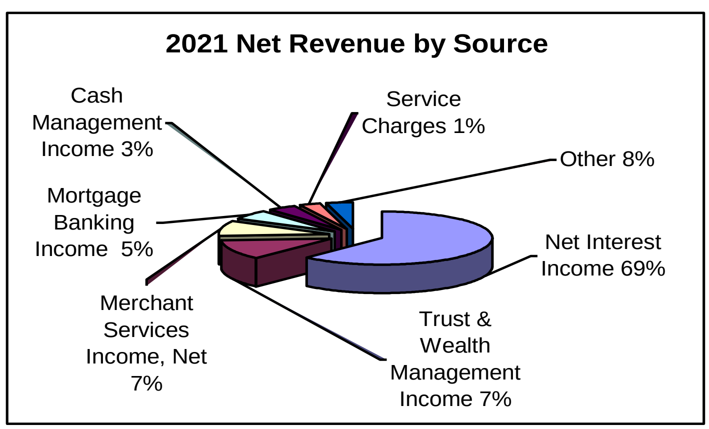
Source: Zacks Analyst

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 0.7% year to date, a better performance than the 8.1% price decrease for the S&P 500, and just below the 2.4% median price gain for the small-cap bank industry, as shown in the following table.

At its current price, CPKF is trading slightly below the industry median P/E, based upon our current CPKF EPS estimate for 2022. Assuming a small-cap bank industry valuation of 11.4X for 2022, CPKF's target price based upon our 2022 EPS estimate is about $31.00.

Turning to Price/Tangible Book Value, CPKF is currently valued at 1.14X. Assuming CPKF trades at the median 1.19X 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 $33.00, which compares to CPKF's current book value of $26.67.

We have chosen the $32.00 midpoint of the range of values based upon CPKF's 2022 P/E of $31.00 and forward Price/Tangible Book Value of $33.00 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	**(0.7)**	**9.6**	**11.1**		**11.9**	**11.1**	**1.14**	**1.19**	**1.9**
S&P 500	**(8.1)**	**25.0**	**19.3**	**17.5**	**-----**	**-----**	**-----**	**-----**	**1.4**
Median	**2.4**	**9.5**	**11.4**	**9.5**	**13.1**	**10.2**	**1.18**	**1.09**	**2.3**
Average	4.2	10.0	11.9	10.0	13.0	10.9	1.2	1.1	2.1
High	48.9	21.2	21.3	15.2	23.5	19.6	2.1	2.0	4.5
Low	(10.8)	6.4	6.9	6.6	(0.2)	2.9	(0.0)	0.2	-----

*Trailing twelve months

Chesapeake Financial Shares, Inc.

Income Statement and Balance Sheet

(Dollars in millions, except per share data)

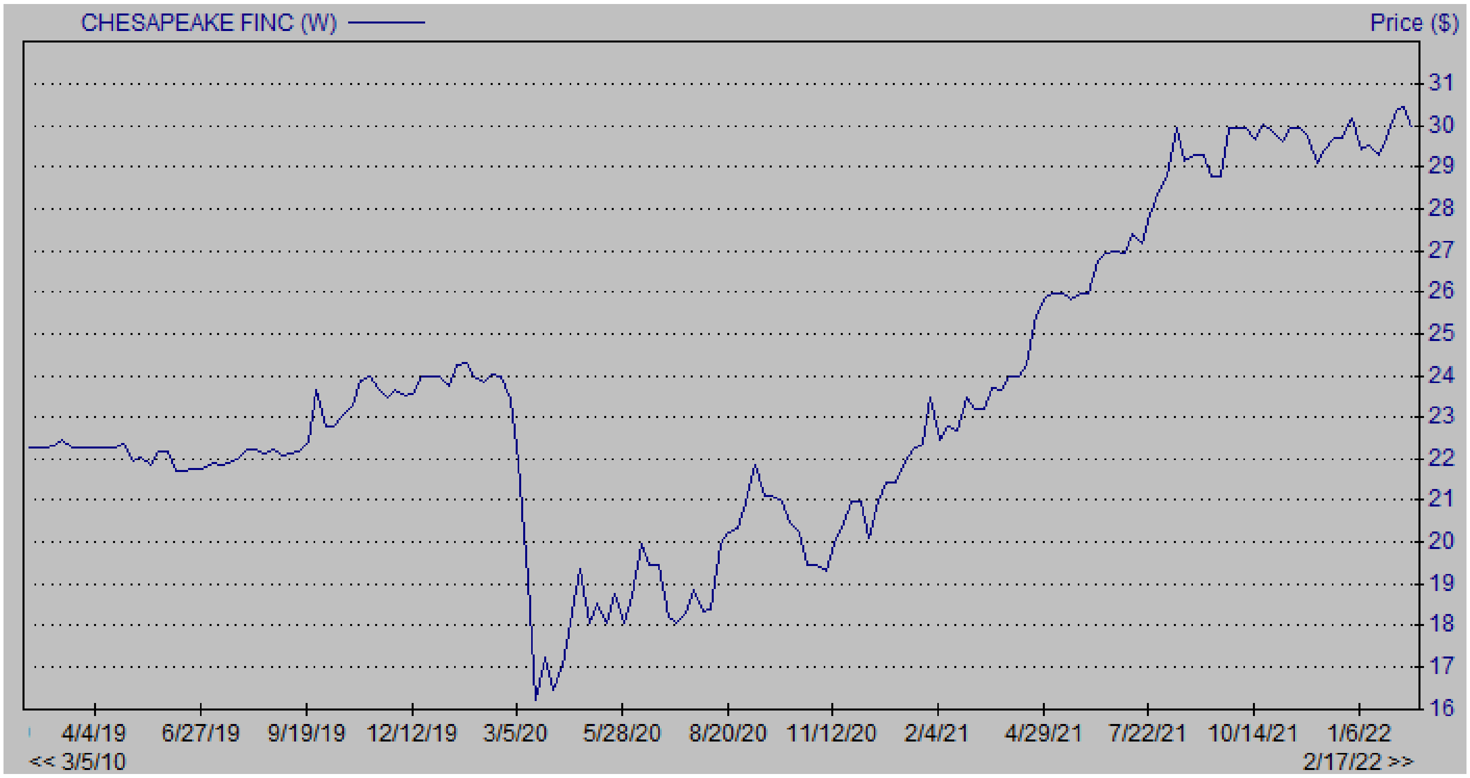
Summary Financial Data	**12/16**	**12/17**	**12/18**	**12/19**	**12/20**	**12/21P**	**12/22E**
Net interest income	24.4	26.0	27.4	29.5	33.5	41.6	40.3
Non-interest income	14.7	18.1	18.6	20.3	19.6	18.9	19.2
Total net revenue	39.1	44.1	46.0	49.8	53.1	60.5	59.5
Loan loss provision	0.5	0.9	0.5	0.5	2.0	(0.4)	0.7
Non-interest expense	30.4	31.8	33.3	36.0	37.3	43.6	43.5
Income taxes & other	1.2	2.5	1.4	1.9	2.1	2.3	2.3
Zacks adjusted income before NRI	7.0	8.9	10.8	11.4	11.7	15.0	13.0
GAAP net income	7.0	8.9	10.8	11.4	11.7	15.0	13.0
Diluted EPS before NRI	1.42	1.80	2.17	2.29	2.40	3.11	2.70
Reported EPS	1.42	1.80	2.17	2.29	2.40	3.11	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	98.8	94.9
Outstandings, gross	481.4	523.7	546.0	566.7	625.0	699.7	757.4
Total assets	720.8	785.2	854.8	958.3	1,204.7	1,385.8	1,529.7
Core deposits	522.3	632.4	702.0	799.5	984.2	1,101.6	1,216.0
Purchased funds	97.4	53.1	47.2	39.6	85.3	122.4	124.4
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	126.1	136.4
Profitability							
Return on avg assets	0.99%	1.16%	1.32%	1.22%	1.06%	1.16%	0.89%
Return on avg equity	8.89%	10.64%	12.07%	11.09%	10.27%	11.91%	9.85%
Net interest margin	4.38%	4.30%	4.10%	3.98%	3.80%	3.83%	3.30%
Loan loss provision % avg assets	0.08%	0.12%	0.06%	0.06%	0.18%	(0.03)%	0.05%
Noninterest income % avg assets	2.06%	2.34%	2.27%	2.18%	1.76%	1.47%	1.31%
Noninterest expense % avg assets	4.28%	4.11%	4.06%	3.86%	3.36%	3.38%	2.99%
Preprovision pretax income % avg assets	1.23%	1.59%	1.55%	1.48%	1.42%	1.31%	1.09%
Tangible efficiency ratio	78%	72%	73%	75%	72%	73%	73%
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)%	0.38%	0.11%
Allowance % outstandings	1.34%	1.17%	1.22%	1.18%	1.47%	1.17%	1.10%
NPAs % loans + OREO	2.21%	1.73%	1.93%	1.36%	1.11%	0.73%	0.78%
Allowance % NPAs	60%	68%	63%	86%	132%	161%	141%
Liquidity & Funding							
Liquid assets % purchased funds	42%	95%	155%	247%	141%	81%	76%
Core deposits % outstandings	108%	121%	129%	141%	157%	157%	161%
Liquid assets % assets	6%	6%	9%	10%	10%	7%	6%
Outstandings % assets	67%	67%	64%	59%	52%	50%	50%
Capital Adequacy							
Total equity % assets	10.81%	11.05%	10.85%	11.00%	10.18%	9.10%	
Tangible equity % assets	10.81%	11.05%	10.85%	11.00%	10.18%	9.10%	
Tier 1 capital ratio	14.16%	14.35%	15.04%	15.03%	14.03%	12.28%	
Total capital ratio	15.30%	15.37%	16.08%	16.00%	15.20%	15.16%	
Parent Company Statistics							
Interest coverage	9.6X	12.7X	8.2X	12.4X	41.2X		
Interest & dividend coverage	0.5X	0.8X	0.6X	1.0X	2.0X		
Short-term debt coverage	Lge	Lge	Lge	Lge	Lge		
Total debt coverage	1.2X	2.8X	2.7X	5.0X	4.8X		
Double leverage	102.6%	102.3%	102.6%	102.5%	102.1%		

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 A**
Net interest income	7.6	8.2	8.4	9.3	10.8	9.7	10.8	10.3
Non-interest income	5.7	4.0	5.3	4.6	4.7	5.6	4.5	4.1
Total net revenue	13.3	12.2	13.7	13.9	15.5	15.3	15.3	14.4
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	12.6
Income taxes & other	0.6	0.2	0.6	0.6	1.0	1.2	0.1	(0.0)
Zacks adjusted income before NRI	3.4	2.1	3.4	2.9	5.3	4.0	3.8	2.0
GAAP net income	3.4	2.1	3.4	2.9	5.3	4.0	3.8	2.0
Diluted EPS before NRI	0.68	0.42	0.69	0.61	1.08	0.82	0.78	0.42
Reported EPS	0.68	0.42	0.69	0.61	1.08	0.82	0.78	0.42
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	98.8
Outstandings, gross	563.2	639.3	639.6	625.0	648.6	637.8	651.8	699.7
Total assets	951.4	1,114.7	1,172.2	1,204.7	1,238.3	1,292.7	1,328.8	1,385.8
Core deposits	796.4	901.7	955.0	984.2	1,023.5	1,045.3	1,074.1	1,101.6
Purchased funds	37.6	84.6	84.0	85.3	78.5	84.4	93.2	122.4
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	126.1
Profitability								
Return on avg assets*	1.41%	0.79%	1.18%	0.99%	1.72%	1.25%	1.15%	0.59%
Return on avg equity *	12.81%	7.52%	11.76%	9.84%	17.21%	12.61%	11.71%	6.32%
Net interest margin*	3.79%	3.88%	3.73%	3.83%	4.21%	3.66%	3.88%	3.58%
Loan loss provision % avg assets*	0.22%	0.24%	0.22%	0.06%	0.06%	0.06%	(0.16)%	(0.07)%
Noninterest income % avg assets*	2.37%	1.55%	1.85%	1.55%	1.56%	1.76%	1.38%	1.20%
Noninterest expense % avg assets*	3.68%	3.58%	3.17%	3.44%	2.96%	3.14%	3.64%	3.73%
Preprovision pretax inc.% avg assets*	1.88%	1.14%	1.60%	1.25%	2.12%	1.69%	1.02%	0.51%
Tangible efficiency ratio	73%	76%	66%	73%	58%	68%	78%	88%
Payout ratio	18%	30%	18%	21%	12%	16%	17%	33%
Asset Quality								
Net charge-offs % avg outstandings*	0.01%	(0.07)%	(0.47)%	0.29%	(0.01)%	(0.03)%	1.55%	0.00%
Allowance % outstandings	1.28%	1.24%	1.45%	1.47%	1.46%	1.52%	1.18%	1.17%
NPAs % loans + OREO	1.37%	1.18%	1.30%	1.11%	0.99%	0.95%	0.89%	0.73%
Allowance % NPAs	93%	104%	91%	104%	145%	160%	131%	161%
Liquidity & Funding								
Liquid assets % purchased funds	221%	113%	136%	136%	129%	152%	115%	81%
Core deposits % outstandings	141%	141%	149%	154%	158%	164%	165%	157%
Liquid assets % assets	9%	9%	10%	10%	8%	10%	8%	7%
Outstandings % assets	59%	57%	55%	53%	52%	49%	49%	50%
Capital Adequacy								
Total equity % assets	11.03%	10.16%	9.98%	10.18%	9.85%	10.03%	9.64%	9.10%
Tangible equity % assets	11.03%	10.16%	9.98%	10.18%	9.85%	10.03%	9.64%	9.10%
Tier 1 capital ratio	15.05%	14.51%	14.20%	14.03%	14.05%	13.83%	13.34%	12.28%
Total capital ratio	16.07%	15.58%	15.42%	15.20%	15.19%	17.29%	16.40%	15.16%

*Annualized.

HISTORICAL STOCK PRICE



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