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Zacks Small-Cap Research

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Chesapeake Financial Shares, Inc. (CPKF-OTCQX)

CPKF: Earnings Down 36% in 2023

We have chosen $22.00 as our new valuation, based upon CPKF's 2024 P/E of $21.50 and forward Price/Tangible Book Value of $22.50. $20.50.

Current Price (02/12/24)	$18.10
Valuation	**$22.00**

OUTLOOK

CPKF's fourth quarter net earnings fell $2.4 million year over year, or 74%, to $0.9 million, while 2023's fourth quarter diluted EPS dropped by $0.52, or 73%, to $0.19 from $0.71 posted a year ago. This was worse than our estimate, which had called for a $0.9 million decrease in net earnings to $2.5 million (off by $1.3 million) and a $0.17 decline in diluted EPS to $0.54 (off by $0.35). The major reasons for the fourth quarter's $2.4 million decrease in net earnings versus the prior-year quarter were a $1.7 million, or 14%, rise in total noninterest expense from greater compensation costs and other miscellaneous noninterest expense, as well as a $0.7 million, or 2%, drop in net interest income and a $0.2 million increase in income taxes due to a higher effective tax rate, partly offset by a $0.2 million, or 4%, increase in noninterest income. For the year, CPKF posted net income of $10.1 million, or $2.15 per diluted share, down 36% from the $15.9 million, or $3.37 per diluted share, posted in 2022. Results in 2022 exclude a third quarter one-time gain on the sale of a partial interest in a brokerage firm of $2.2 million pretax and $1.7 million aftertax, or $0.36 per diluted share. We are reviewing our 2024 estimates. CPKF just raised the quarterly dividend by 3% to $0.155 per share from $0.15 per share and has raised its annual dividend payment every year for the past thirty-one years since 1991. In 2023 for the sixteenth consecutive year, CPKF was included in the American Banker magazine list of the "Top 200 Community Banks".

SUMMARY DATA

52-Week High	**$23.95**
52-Week Low	**$16.51**
One-Year Return (%)	**-17.98**
Beta	**0.47**
Average Daily Volume (sh)	**444**
Shares Outstanding (mil)	**5**
Market Capitalization ($mil)	**$85**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**4**
Insider Ownership (%)	**40**
Annual Cash Dividend	**$0.62**
Dividend Yield (%)	**3.43**
5-Yr. Historical Growth Rates	
Net Revenue (%)	**6.8**
Earnings Per Share (%)	**(0.2)**
Dividend (%)	**5.7**
P/E using TTM EPS	**8.4**
P/E using 2023 Actual	**8.4**
P/E using 2024 Estimate	**7.0**
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)
2021	15.5 A	15.3 A	15.3 A	14.4 A	60.5 A
2022	15.5 A	16.0 A	16.6 A	15.9 A	64.0 A
2023	15.6 A	16.4 A	16.5 A	15.4 A	63.9 A
2024					66.1 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2021	1.08 A	0.82 A	0.78 A	0.42 A	3.11 A
2022	0.90 A	0.86 A	0.90 A	0.71 A	3.37 A
2023	0.78 A	0.65 A	0.53 A	0.19 A	2.15 A
2024					2.60 E

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

FOURTH QUARTER

CPKF's fourth quarter net earnings fell $2.4 million year over year, or 74%, to $0.9 million, while 2023's fourth quarter diluted EPS dropped by $0.52, or 73%, to $0.19 from $0.71 posted a year ago.

This was worse than our estimate, which had called for a $0.9 million decrease in net earnings to $2.5 million (off by $1.3 million) and a $0.17 decline in diluted EPS to $0.54 (off by $0.35).

The primary reasons for the difference between reported results and our estimate were that net revenues were $0.1 million less than the $15.5 million we had anticipated, largely consisting of noninterest income that was $0.7 million lower than our projection due to $1.0 million in net securities losses (versus our $0 estimate) and other miscellaneous income that was $0.3 million better than our estimate, partly offset by net interest income that was $0.6 million higher than our estimate.

We note that CPKF has been repositioning its securities portfolio in both 2023 and 2022 to take advantage of higher interest rates. This resulted in $1.0 million in net securities losses in 2023's fourth quarter versus $0.1 million in net securities losses in the year-ago quarter, as well as $2.9 million in net securities losses for full-year 2023, compared to $3.3 million in net securities losses in 2022.

On the other hand, total noninterest expense of $14.0 million was $1.7 million more than we had projected, primarily reflecting compensation expense that was $0.3 million higher than anticipated, as well as larger other miscellaneous noninterest expense that was $1.1 million more than we thought it would be and occupancy expense that was $0.3 million higher than estimated.

The major reasons for the fourth quarter's $2.4 million decrease in net earnings versus the prior-year quarter were a $1.7 million, or 14%, rise in total noninterest expense from greater compensation costs and other miscellaneous noninterest expense, as well as a $0.7 million, or 2%, drop in net interest income and a $0.2 million increase in income taxes due to a higher effective tax rate, partly offset by a $0.2 million, or 4%, increase in noninterest income.

For the year, CPKF posted net income of $10.1 million, or $2.15 per diluted share, down $5.8 million, or 36% from the $15.9 million, or $3.37 per diluted share, posted in 2022. Results in 2022 exclude a third quarter one-time gain on the sale of a partial interest in a brokerage firm of $2.2 million pretax and $1.7 million aftertax, or $0.36 per diluted share.

Primary contributors to this result were a $2.3 million, or 12%, gain in noninterest income from higher cash management fee income and miscellaneous noninterest income. These positives were more than offset by a $5.7 million, or 14%, increase in noninterest expense, largely due to higher other miscellaneous noninterest expense (up $2.8 million, or 18%) and compensation costs (up $2.8 million, or 11%), a $2.5 million, or 6%, decline in net interest income due to a lower net interest margin, and an effective tax rate that was 530 basis more than the 12.7% posted a year ago.

As to quarterly results, net interest income fell $0.7 million, or 6%, year over year in the fourth quarter to $10.8 million ($0.6 million above our $10.2 million estimate), as an estimated 3% increase in average interest-earning assets was offset by a net interest margin of 3.54% that was 39 basis points lower than the 3.93% earned in the year-ago quarter. Solid growth in interest income was not sufficient to offset accelerating increases in deposit costs, similar to the experience of much of the banking industry.

Noninterest income increased $0.2 million, or 4%, year over year to $4.6 million, primarily reflecting higher net securities losses (up $0.9 million), which were partly offset by gains in cash management fee income (up $0.5 million) and miscellaneous noninterest income (up $0.6 million).

Noninterest expense advanced $1.7 million, or 14%, to $14.0 million ($1.7 million more than the $12.3 million we had projected) from the prior-year quarter, largely reflecting greater compensation costs (up

$1.0 million) and other miscellaneous noninterest expense (up $0.7 million), partly reflecting higher check fraud losses that CPKF is attempting to recoup from other banks.

The loan loss provision was flat at $175,000 compared to the year-ago quarter and was the same as our estimate. Loan loss reserves were flat at $7.8 million (0.95% of loans) compared with the third quarter (0.98% of loans) and were $0.3 million above the $7.5 million (1.00% of loans) in the year-ago quarter. As to other asset quality measures, CPKF recorded net charge-offs of $137,000 in the fourth quarter. This compares to net charge-offs of $34,000 in the year-ago quarter and net charge-offs of $233,000 for the full year in 2023.

CEO Jeffrey M. Szyperski noted that CPKF's total nonperforming assets to total assets fell 28 basis points to 0.255%% of total loans at December 31, 2023 from 0.539% at December 31, 2022.

Gross loans increased $81 million, or 11%, year over year, and about $27 million, or 3%, sequentially to $830 million.

CPKF posted a 3.9% ROE and 0.25% ROA for the fourth quarter of 2023, compared to 17.7% and 1.00%, respectively, in the prior-year quarter.

During the second quarter, CPKF opened another branch, this time in a retirement community in Richmond, Virginia. It is CPKF's sixth branch in a retirement community, which is attractive due to its low cost of entry, as well as being a feeder for the Company's investment management and deposit-gathering activities. In addition, in August CPKF opened a loan production office in Newport News, Virginia.

At the October 27, 2023 Chesapeake Financial Shares Board of Directors meeting, the Board raised the quarterly dividend to $0.155 per share from $0.15 per share (a 3% increase), paid on December 15, 2023. Notably, CPKF has increased the annual dividend payment every year for the past thirty-one years since 1991.

In 2023 for the sixteenth 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 #58 in the nation out of approximately 6,000 community banks in the study, up from #130 last year and #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 14.34%.

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

OVERVIEW

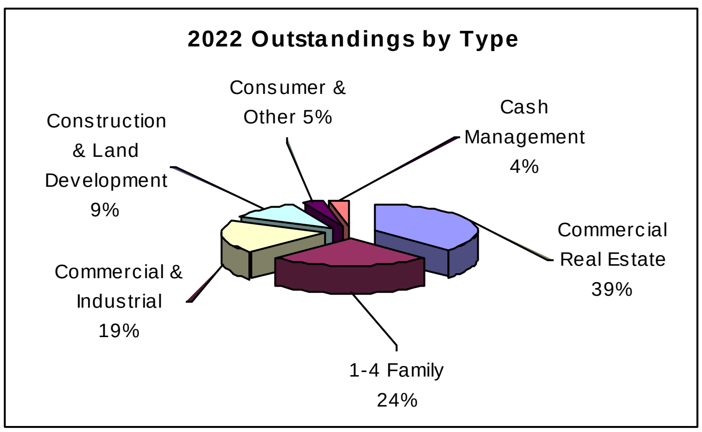
Chesapeake Financial Shares, Inc. (CPKF or the Company) is a financial holding company headquartered in Kilmarnock, Virginia, with $1,471 million in total assets at December 31, 2023. CPKF is predominantly a small business lender with 17 branch offices and one loan production office that serve customers 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 $431 million in assets (at 2022 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 2022, Chesapeake Payment Systems had 893 direct merchants in its system and processed over $381 million in merchant card transactions. In addition, Chesapeake Payment Systems has also partnered with eight 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 49 customers at the end of 2022.

Through Chesapeake’s secondary market mortgage banking operation, the Company services a $304 million loan portfolio (as of December 31, 2022) of residential mortgage loans for Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac), for which it earns a 25 basis-point fee (approximately $763,000 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 $916,000 to revenues in 2022 (both types of fees are included in other noninterest income in the Company’s financial statements).

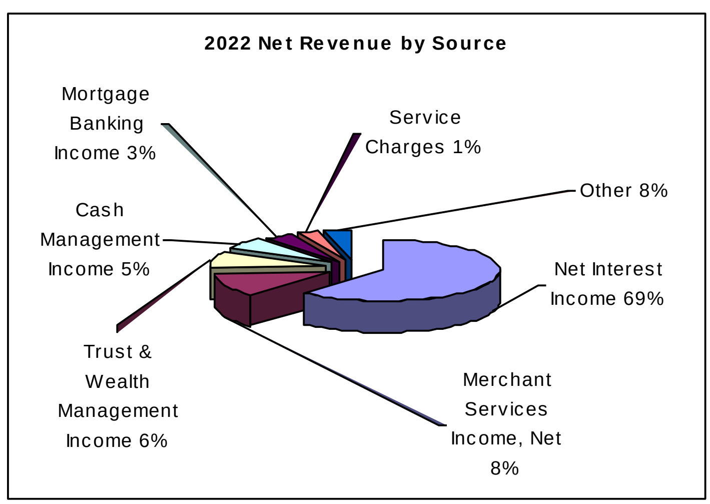


Source: Zacks Analyst

The lending portfolio is dominated by real estate loans, as shown in the chart at left. At December 31, 2022, the lending book consisted of commercial real estate (accounting for 39% of total gross outstandings), 1-4 family (24%), commercial and industrial (19%), construction and land development (9%), consumer and other (5%), 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, 2022, the liquidity portfolio, which consists of cash, short-term investments, federal funds sold, and US agency mortgage obligations, represented about 6% of total assets and 12% of the securities portfolio. In addition, the available-for-sale portfolio includes municipal at 53% of the total, private label mortgage securities at 25%, and asset-backed and other securities at 10%. Core deposits represented 98% of total deposits at December 31, 2022, with certificates of deposit larger than $250,000 at 2%.

Source: Zacks Analyst



In 2022, net interest income contributed 69% of net revenue, with a significant 31% coming from noninterest income sources. Major contributors to noninterest income include merchant services income, net (8% of net revenue) trust and wealth management income (6%), cash management fee income (5%), mortgage banking income (3%), and service charges (1%)

VALUATION

CPKF stock is down 1.1% year to date, better than the 11.0% median price decline for our small-cap bank universe, but worse than the 5.3% price increase for the S&P 500, as shown in the following table.

At its current price, CPKF is trading at a 16% discount to the industry median P/E, based upon our current CPKF EPS estimate for 2024. Assuming a median small-cap bank universe valuation of 8.3X, CPKF's target price based upon our 2024 EPS estimate is about $21.50.

Turning to Price/Tangible Book Value, CPKF is currently valued at 0.9X. Assuming a 1.0X multiple based upon our estimated tangible book value twelve months out, our target price is about $22.50, which compares to CPKF's current tangible book value per share of $18.10.

We have chosen $22.00 as our new valuation, based upon CPKF's 2024 P/E of $21.50 and forward Price/Tangible Book Value of $22.50.

Industry Comparables - Small-cap Banks

	Pr Chg YTD	EPS TTM*	EPS 2023A	EPS 2024E	ROE TTM*	ROE 5-Yr Avg	ROA TTM*	ROA 5-Yr Avg	Div Yld
Chesapeake Finc'l	**(1.1)**	**8.4**	**8.4**	**7.0**	**11.1**	**13.2**	**0.73**	**1.15**	**3.4**
S&P 500	**5.3**	**23.9**	**21.3**	**19.4**	**34.5**	**N/A**	**13.0**	**N/A**	**1.5**
Median	**(11.0)**	**8.6**	**9.6**	**8.3**	**11.3**	**11.4**	**0.90**	**1.12**	**3.3**
Average	(9.2)	9.8	11.2	9.9	10.9	11.9	1.0	1.1	3.2
High	54.3	30.6	50.7	36.3	17.5	18.6	1.7	1.9	6.2
Low	(28.7)	5.6	7.0	5.4	4.0	3.7	0.3	0.2	-----

*Trailing twelve months

Chesapeake Financial Shares, Inc.

Income Statement and Balance Sheet

(Dollars in millions, except per share data)

Summary Financial Data	**12/18**	**12/19**	**12/20**	**12/21**	**12/22**	**12/23P**	**12/24E**
Net interest income	27.4	29.5	33.5	41.6	44.1	41.6	41.6
Non-interest income	18.6	20.3	19.6	18.9	19.9	22.3	24.4
Total net revenue	46.0	49.8	53.1	60.5	64.0	63.9	66.1
Loan loss provision	0.5	0.5	2.0	(0.4)	0.7	0.8	0.8
Non-interest expense	33.3	36.0	37.3	43.6	45.1	50.7	50.9
Income taxes & other	1.4	1.9	2.1	2.3	2.3	2.3	2.5
Zacks adjusted income before NRI	10.8	11.4	11.7	15.0	15.9	10.1	12.0
GAAP net income	10.8	11.4	11.7	15.0	17.6	10.1	12.0
Diluted EPS before NRI	2.17	2.29	2.39	3.11	3.37	2.15	2.60
Reported EPS	2.17	2.29	2.39	3.11	3.73	2.15	2.60
Dividends per share	0.46	0.49	0.50	0.53	0.58	0.61	0.62
Liquid assets	73.1	98.0	120.2	98.8	79.6	95.0	88.8
Outstandings, gross	546.0	566.7	625.0	699.7	778.1	864.4	926.1
Total assets	854.8	958.3	1,204.7	1,385.8	1,329.0	1,471.0	1,492.1
Core deposits	702.0	799.5	984.2	1,101.6	1,144.5	1,148.3	1,152.7
Purchased funds	47.2	39.6	85.3	122.4	67.8	180.1	189.3
Long-term debt	5.2	5.2	5.2	25.2	25.2	25.2	25.2
Shareholders' equity	92.7	105.4	122.7	126.1	79.1	98.5	106.5
Profitability							
Return on avg assets	1.32%	1.22%	1.06%	1.14%	1.19%	0.74%	0.83%
Return on avg equity	12.07%	11.09%	10.27%	11.87%	18.88%	11.42%	12.25%
Net interest margin	4.10%	3.98%	3.80%	3.80%	3.70%	3.48%	3.30%
Loan loss provision % avg assets	0.06%	0.06%	0.18%	(0.03)%	0.05%	0.06%	0.06%
Noninterest income % avg assets	2.27%	2.18%	1.76%	1.44%	1.49%	1.63%	1.69%
Noninterest expense % avg assets	4.06%	3.86%	3.36%	3.32%	3.37%	3.71%	3.51%
Preprovision pretax income % avg assets	1.55%	1.48%	1.42%	1.29%	1.42%	0.96%	1.05%
Tangible efficiency ratio	73%	75%	72%	73%	67%	76%	76%
Payout ratio	21%	21%	21%	17%	16%	28%	24%
Asset Quality							
Net charge-offs % avg outstandings	0.02%	0.10%	(0.05)%	0.38%	(0.03)%		0.07%
Allowance % outstandings	1.22%	1.18%	1.47%	1.17%	1.21%	0.91%	1.15%
NPAs % loans + OREO	1.93%	1.36%	1.11%	0.61%	0.52%		0.47%
Allowance % NPAs	63%	86%	132%	194%	232%		244%
Liquidity & Funding							
Liquid assets % purchased funds	155%	247%	141%	81%	117%	53%	47%
Core deposits % outstandings	129%	141%	157%	157%	147%	133%	124%
Liquid assets % assets	9%	10%	10%	7%	6%	6%	6%
Outstandings % assets	64%	59%	52%	50%	59%	59%	62%
Capital Adequacy							
Total equity % assets	10.85%	11.00%	10.18%	9.10%	5.95%	6.70%	7.14%
Tangible equity % assets	10.85%	11.00%	10.18%	9.10%	5.95%	6.36%	6.69%
Tier 1 capital ratio	15.04%	15.03%	14.03%	12.28%	13.04%		
Total capital ratio	16.08%	16.00%	15.20%	15.16%	15.89%		
Parent Company Statistics							
Interest coverage	8.2X	12.4X	41.2X	3.7X	4.7X	11.0X	11.0X
Interest & dividend coverage	0.6X	1.0X	2.0X	0.5X	1.1X	0.7X	0.7X
Short-term debt coverage	Lge	Lge	Lge	Lge	Lge	Lge	Lge
Total debt coverage	2.7X	5.0X	4.8X	0.7X	1.3X	1.3X	1.3X
Double leverage	102.6%	102.5%	102.1%	117.5%	128.2%	126.5%	117.4%

Chesapeake Financial Shares, Inc.

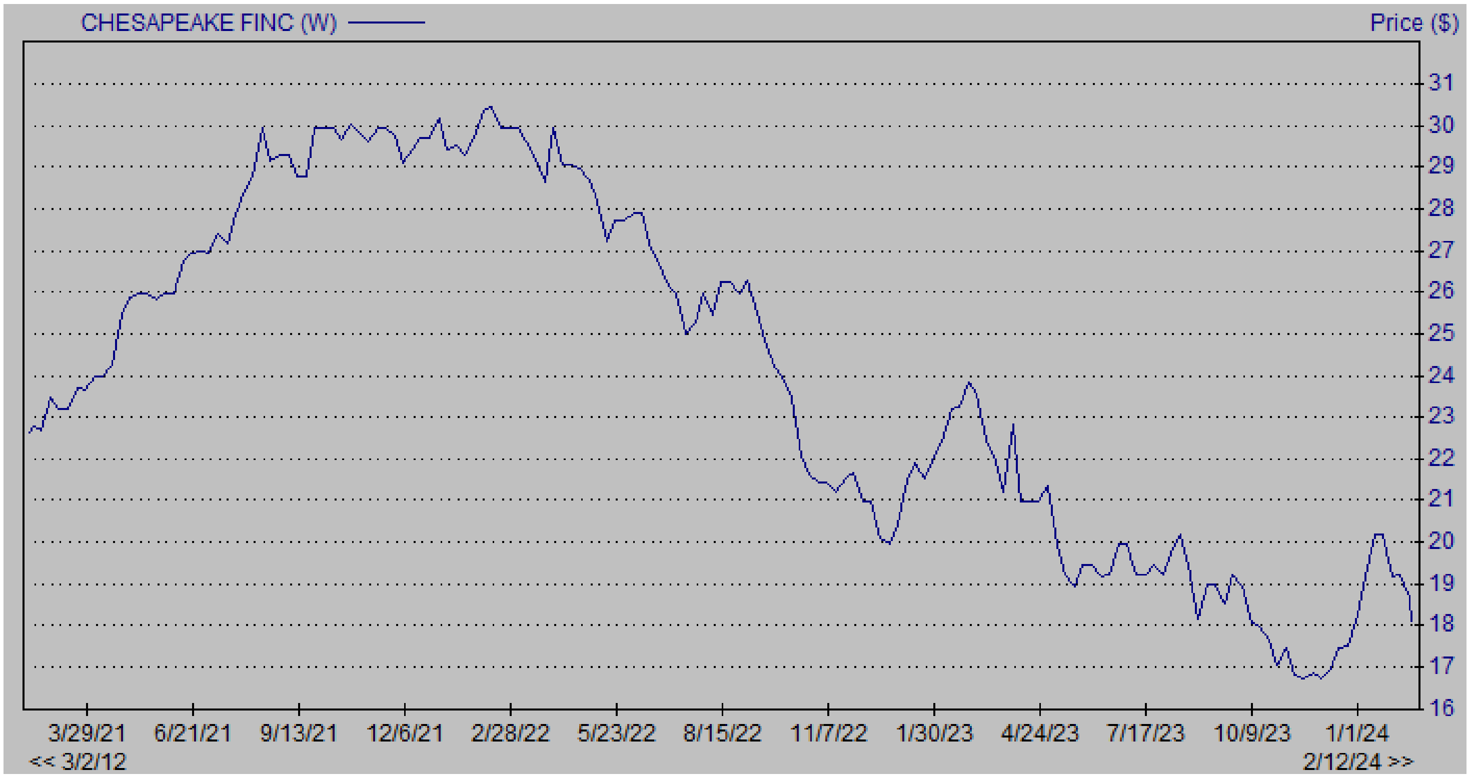
Income Statement and Balance Sheet

(Dollars in millions, except per share data)

	2022				2023			
Summary Financial Data	**Q1 A**	**Q2 A**	**Q3 A**	**Q4 A**	**Q1 A**	**Q2 A**	**Q3 A**	**Q4 P**
Net interest income	10.5	10.8	11.3	11.5	10.6	10.2	10.0	10.8
Non-interest income	5.0	5.2	5.3	4.4	5.0	6.2	6.5	4.6
Total net revenue	15.5	16.0	16.6	15.9	15.6	16.4	16.5	15.4
Loan loss provision	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.2
Non-interest expense	10.3	11.0	11.4	12.3	11.0	12.5	13.2	14.0
Income taxes & other	0.7	0.7	0.8	0.1	0.7	0.7	0.5	0.3
Zacks adjusted income before NRI	4.3	4.1	4.2	3.3	3.7	3.0	2.5	0.9
GAAP net income	4.3	4.1	5.9	3.3	3.7	3.0	2.5	0.9
Diluted EPS before NRI	0.90	0.86	0.90	0.71	0.78	0.65	0.53	0.19
Reported EPS	0.90	0.86	1.26	0.71	0.78	0.65	0.53	0.19
Dividends per share	0.14	0.14	0.15	0.15	0.15	0.15	0.15	0.16
Liquid assets	93.2	92.0	80.3	79.6	82.2	87.3	84.5	95.0
Outstandings, gross	719.3	734.0	751.8	778.1	797.1	818.7	836.8	864.4
Total assets	1,346.1	1,342.0	1,333.9	1,329.0	1,331.4	1,354.8	1,382.3	1,471.0
Core deposits	1,138.1	1,172.6	1,165.3	1,144.5	1,112.4	1,100.9	1,110.4	1,148.3
Purchased funds	73.0	49.0	59.7	67.8	91.3	125.2	148.3	180.1
Long-term debt	25.2	25.2	25.2	25.2	25.2	25.2	25.2	25.2
Shareholders' equity	101.0	85.2	72.2	79.1	89.3	90.9	85.6	98.5
Profitability								
Return on avg assets*	1.25%	1.21%	1.27%	1.00%	1.11%	0.91%	0.72%	0.25%
Return on avg equity *	15.05%	17.45%	21.58%	17.69%	17.56	13.50	11.23	3.93%
Net interest margin*	3.53%	3.64%	3.79%	3.93%	3.58%	3.45%	3.37%	3.54%
Loan loss provision % avg assets*	0.05%	0.05%	0.05%	0.05%	0.05%	0.05%	0.08%	0.05%
Noninterest income % avg assets*	1.48%	1.54%	1.59%	1.32%	1.51%	1.84%	1.89%	1.28%
Noninterest expense % avg assets*	3.02%	3.26%	3.42%	3.71%	3.30%	3.72%	3.87%	3.94%
Preprovision pretax inc.% avg assets*	1.51%	1.50%	1.55%	1.08%	1.39%	1.16%	0.96%	0.38%
Tangible efficiency ratio	67%	69%	70%	77%	70%	70%	79%	85%
Payout ratio	16%	16%	12%	21%	19%	23%	28%	81%
Asset Quality								
Net charge-offs % avg outstandings*	(0.02)%	(0.12)	0.01%	(0.00)%	0.02%	0.02%	0.01%	
Allowance % outstandings	1.18%	1.22%	1.22%	1.21%	1.21%	1.20%	1.20%	1.09%
NPAs % loans + OREO	0.57%	0.49%	0.42%	0.52%	0.51%	0.36%	0.40%	
Allowance % NPAs	208%	250%	293%	232%	237%	337%	298%	
Liquidity & Funding								
Liquid assets % purchased funds	128%	188%	134%	117%	90%	70%	57%	53%
Core deposits % outstandings	158%	160%	155%	147%	140%	134%	133%	133%
Liquid assets % assets	7%	7%	6%	6%	6%	6%	6%	6%
Outstandings % assets	53%	55%	56%	59%	60%	60%	61%	59%
Capital Adequacy								
Total equity % assets	7.51%	6.35%	5.41%	5.95%	6.71%	6.71%	6.19%	6.70%
Tangible equity % assets	7.51%	6.35%	5.41%	5.95%	6.71%	6.71%	5.69%	6.36%
Tier 1 capital ratio	12.37%	12.47%	12.61%	13.04%	13.13%	12.66%	11.83%	
Total capital ratio	15.23%	15.34%	15.41%	15.89%	15.98%	15.41%	14.56%	

*Annualized.

HISTORICAL STOCK PRICE



DISCLOSURES

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