



Chesapeake Financial Shares (CPKF)

Updated July 23rd, 2022, by Josh Arnold

Key Metrics

| | | | | | |
|-----------------------------|------|--|------|----------------------------------|-----------------------|
| Current Price: | \$25 | 5 Year CAGR Estimate: | 8.3% | Market Cap: | \$119 M |
| Fair Value Price: | \$31 | 5 Year Growth Estimate: | 2.0% | Ex-Dividend Date: | 08/31/22 ¹ |
| % Fair Value: | 82% | 5 Year Valuation Multiple Estimate: | 4.1% | Dividend Payment Date: | 09/15/22 |
| Dividend Yield: | 2.4% | 5 Year Price Target | \$34 | Years Of Dividend Growth: | 29 |
| Dividend Risk Score: | A | Retirement Suitability Score: | B | Rating: | Hold |

Overview & Current Events

Chesapeake Financial is a one-bank holding company headquartered in Virginia. It was founded in 1900 and despite its long operating history, has grown to only 16 locations, offering community banking and wealth management services. The company's market capitalization is \$119 million, and it produces about \$60 million in annual revenue. Chesapeake has also boosted its dividend for 29 consecutive years, although it is too small to be a Dividend Aristocrat. The bank has \$1.3 billion in total assets.

Chesapeake reported second quarter earnings on July 19th, 2022, and results were slightly better than expected. The company posted earnings of \$4.063 million, which was up 2.4% year-over-year. The second quarter of last year included \$660,000 of Paycheck Protection Program fees, so excluding that, the gain would have been 23%. On a per-share basis, earnings were 86 cents, up from 82 cents a year ago.

The CEO said asset quality is "as strong as ever" so the bank is confident in its position heading into what may be a recession on the horizon. Nonperforming assets were 0.46% of loans, down from 0.82% a year ago. Mortgage originations are set to slow in the second half of the year, according to guidance. Net interest margin was 3.74% for the second quarter of 2022, which is extremely high amongst banking peers.

Chesapeake boosted its dividend by 7.1%, to a new payout of 15 cents per quarter. Chesapeake's dividend streak stands at 29 years. We've boosted our estimate for this year to \$3.40, up slightly following Q2 results.

Growth on a Per-Share Basis

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2027 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| EPS | \$1.98 | \$1.90 | \$1.65 | \$1.85 | \$1.75 | \$2.17 | \$2.17 | \$2.29 | \$2.40 | \$3.11 | \$3.40 | \$3.75 |
| DPS | \$0.31 | \$0.35 | \$0.38 | \$0.39 | \$0.41 | \$0.43 | \$0.46 | \$0.49 | \$0.50 | \$0.53 | \$0.60 | \$0.77 |
| Shares² | 3.2 | 3.3 | 4.0 | 4.0 | 4.0 | 4.1 | 4.1 | 4.9 | 4.9 | 4.9 | 4.7 | 4.5 |

Chesapeake successfully navigated the Great Recession, but growth since earnings normalized has been fairly weak at 4.6% annually. We are upgrading our growth forecast to 2% as the expected base of earnings is now quite elevated, and should be a record in 2022. However, it's very low loan-to-deposit ratio could be a source of growth should the bank decide to take advantage of its much higher deposit base. Credit quality is holding up nicely, but management is somewhat cautious. The PPP revenue that carried over from 2020 into 2021 helped with fee generation and growing the earning asset base. We note that earnings are set to make a new record this year despite the headwinds facing the sector.

We also see the dividend continuing to rise at a modest rate for the foreseeable future, keeping its streak of dividend increases alive and seeing the payout rise to 77 cents over the next five years. Indeed, Chesapeake has boosted its dividend for 29 consecutive years, putting it in elite company for income investors, particularly for a bank. The payout ratio is still very low, so we see many years of dividend increases on the horizon.

¹ Estimated date

² Share count in millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Valuation Analysis

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | Now | 2027 |
|-----------|------|------|------|------|------|------|------|------|------|------|------|------|
| Avg. P/E | 6.2 | 7.9 | 9.0 | 8.9 | 11.5 | 12.0 | 11.4 | 9.8 | 8.4 | 8.6 | 7.4 | 9.0 |
| Avg. Yld. | 3.4% | 2.8% | 3.0% | 2.9% | 2.4% | 2.0% | 1.9% | 2.2% | 2.5% | 2.0% | 2.4% | 2.3% |

Chesapeake’s price-to-earnings ratio has declined since our last update, due to a lower share price and higher earnings estimates. Shares now go for 7.4 times projected earnings, versus our fair value estimate of 9 times earnings. With the stock at 82% of our estimate of fair value, we forecast a modest tailwind in the coming years from the valuation. We see the yield remaining essentially where it is, as the valuation rises, the dividend grows, and our price target is \$34. Chesapeake’s valuation is based upon a relatively high base of earnings for 2022.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2027 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 16% | 18% | 23% | 21% | 23% | 20% | 18% | 21% | 21% | 17% | 18% | 20% |

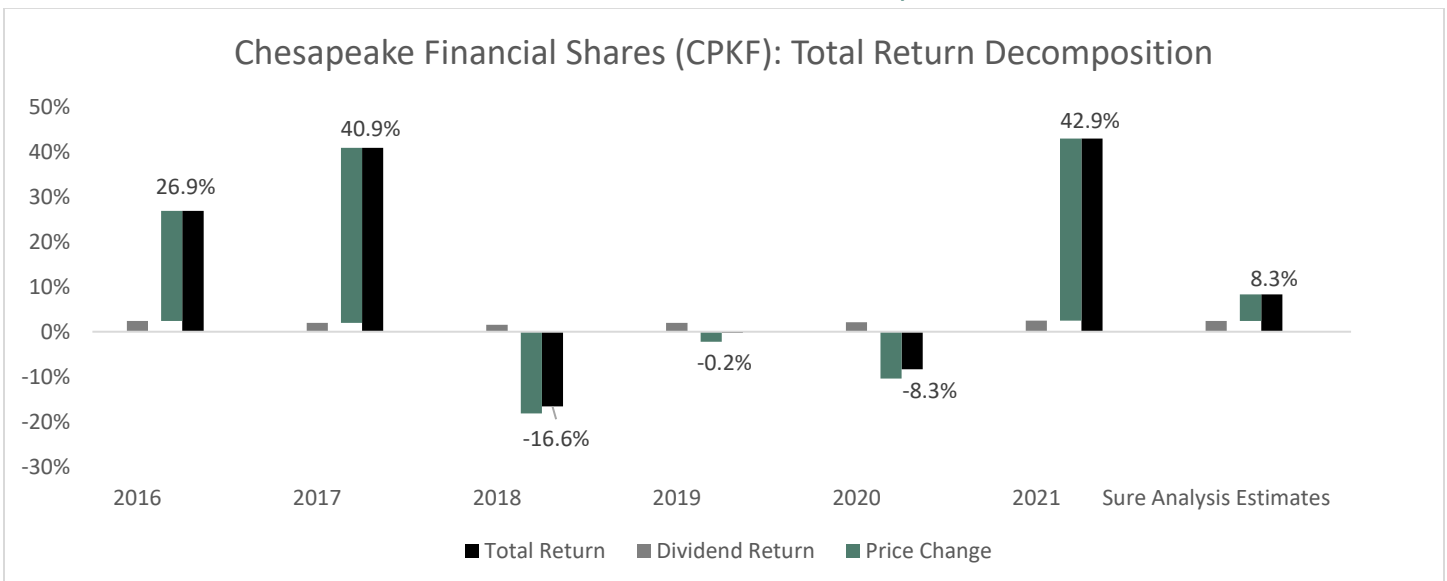
Chesapeake’s payout ratio has always been very low, and we expect it will remain as such in the coming years. The good news is that the streak of dividend increases should be safe in just about any environment, since even an enormous decline in earnings should allow Chesapeake to continue boosting the payout by small increments. Chesapeake came through with a 7% dividend increase for 2022, so we see that as another bullish sign from management.

Chesapeake’s competitive advantage would be its 120+ years of banking experience in its core market areas, but that market seems to be highly penetrated; this is the reason the bank is expanding westward. Its focus on bread-and-butter banking – that is, taking deposits and prudently lending them out – afforded it tremendous resilience during the Great Recession, something that is occurring during this current downturn as well.

Final Thoughts & Recommendation

Chesapeake’s fundamentals are strong at this point. The stock is undervalued in our view, and we’ve boosted earnings estimates since our last update. We expect total annual returns of 8.3% for the next five years, consisting of the current 2.4% yield and a tailwind from the valuation. Shares earn a hold rating once again.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|----------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue | 35 | 37 | 35 | 38 | 40 | 44 | 45 | 49 | 52 | 57 |
| SG&A Exp. | 17 | 17 | 18 | 20 | 21 | 22 | 24 | 26 | 27 | 30 |
| D&A Exp. | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 |
| Net Profit | 8 | 7 | 7 | 7 | 7 | 9 | 11 | 11 | 12 | 15 |
| Net Margin | 21.6% | 19.9% | 18.8% | 19.7% | 17.8% | 20.3% | 23.8% | 23.2% | 22.5% | 25.2% |
| Free Cash Flow | 9 | 13 | 16 | 4 | 10 | 13 | 14 | 10 | 4 | 21 |
| Income Tax | 2 | 2 | 1 | 1 | 1 | 2 | 1 | 2 | 2 | 2 |

Balance Sheet Metrics

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|----------------------|------|------|------|------|------|------|------|------|-------|-------|
| Total Assets | 668 | 663 | 663 | 679 | 721 | 785 | 855 | 958 | 1,205 | 1,386 |
| Cash & Equivalents | 54 | 60 | 27 | 15 | 13 | 18 | 48 | 49 | 70 | 21 |
| Total Liabilities | 607 | 601 | 593 | 603 | 643 | 698 | 762 | 853 | 1,082 | 1,259 |
| Accounts Payable | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Long-Term Debt | 39 | 26 | 21 | 31 | 26 | 15 | 5 | 5 | 55 | 124 |
| Shareholder's Equity | 61 | 62 | 71 | 76 | 78 | 87 | 93 | 105 | 123 | 126 |
| LTD/E Ratio | 0.64 | 0.42 | 0.29 | 0.41 | 0.34 | 0.17 | 0.06 | 0.05 | 0.45 | 0.98 |

Profitability & Per Share Metrics

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|------------------|-------|-------|------|-------|------|-------|-------|-------|-------|-------|
| Return on Assets | 1.2% | 1.1% | 1.0% | 1.1% | 1.0% | 1.2% | 1.3% | 1.3% | 1.1% | 1.2% |
| Return on Equity | 13.7% | 12.0% | 9.9% | 10.1% | 9.1% | 10.9% | 12.1% | 11.5% | 10.3% | 12.1% |
| ROIC | 8.0% | 7.8% | 7.3% | 7.5% | 6.7% | 8.7% | 10.8% | 10.9% | 8.1% | 7.0% |
| Shares Out. | 3.2 | 3.3 | 4.0 | 4.0 | 4.0 | 4.1 | 4.1 | 4.9 | 4.9 | 4.8 |
| Revenue/Share | 7.45 | 7.73 | 7.17 | 7.67 | 8.01 | 8.90 | 9.13 | 9.86 | 10.65 | 12.34 |
| FCF/Share | 1.80 | 2.65 | 3.26 | 0.74 | 1.96 | 2.64 | 2.86 | 1.96 | 0.88 | 4.42 |

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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