



Chesapeake Financial Shares (CPKF)

Updated October 30th, 2023, by Josh Arnold

Key Metrics

| | | | | | |
|-----------------------------|------|--|-------|----------------------------------|-----------------------|
| Current Price: | \$17 | 5 Year CAGR Estimate: | 14.2% | Market Cap: | \$80 M |
| Fair Value Price: | \$26 | 5 Year Growth Estimate: | 3.0% | Ex-Dividend Date: | 12/01/23 ¹ |
| % Fair Value: | 67% | 5 Year Valuation Multiple Estimate: | 8.4% | Dividend Payment Date: | 12/15/23 |
| Dividend Yield: | 3.5% | 5 Year Price Target | \$30 | Years Of Dividend Growth: | 30 |
| Dividend Risk Score: | A | Retirement Suitability Score: | A | Rating: | Buy |

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 \$80 million, and it produces just under \$60 million in annual revenue. Chesapeake has also boosted its dividend for 30 consecutive years, although it is too small to be a Dividend Aristocrat. The bank has \$1.4 billion in total assets.

Chesapeake posted third quarter earnings on October 24th, 2023, and results were largely in line with expectations. Earnings came to \$2.478 million, a 58% decline from the year-ago period. The year-ago period included a non-recurring pre-tax gain of \$2.2 million from the partial sale of its investment brokerage firm. On a per-share basis, earnings fell from \$1.26 to \$0.53.

Total assets ended the quarter at \$1.382 billion, up slightly from the end of 2022. Asset quality remains quite good, as nonperforming assets were 0.376%, compared to 0.431% in last year's Q3. Net interest margin was 3.366% for the quarter. The company also noted Flexent and Chesapeake Payment Systems are providing strong tailwinds to noninterest income.

We now see \$3.00 in earnings-per-share for this year after good Q3 results.

Growth on a Per-Share Basis

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| EPS | \$1.90 | \$1.65 | \$1.85 | \$1.75 | \$2.17 | \$2.17 | \$2.29 | \$2.40 | \$3.11 | \$3.73 | \$3.00 | \$3.48 |
| DPS | \$0.35 | \$0.38 | \$0.39 | \$0.41 | \$0.43 | \$0.46 | \$0.49 | \$0.50 | \$0.53 | \$0.58 | \$0.60 | \$0.77 |
| Shares² | 3.3 | 4.0 | 4.0 | 4.0 | 4.1 | 4.1 | 4.9 | 4.9 | 4.9 | 4.7 | 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 reiterating our growth forecast to 3% as the expected base of earnings is now lower than before, as loan growth in 2023 is seen to be low, and margins are moving lower. However, its 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. Credit quality remains outstanding, and the bank said it is as good as it has ever been.

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 30 consecutive years, putting it in elite company for income investors, particularly for a small bank. The payout ratio is still very low, so we see many years of dividend increases on the horizon, and at an average rate of 5% annually.

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 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | Now | 2028 |
|-----------|------|------|------|------|------|------|------|------|------|------|------|------|
| Avg. P/E | 7.9 | 9.0 | 8.9 | 11.5 | 12.0 | 11.4 | 9.8 | 8.4 | 8.6 | 5.5 | 5.7 | 8.5 |
| Avg. Yld. | 2.8% | 3.0% | 2.9% | 2.4% | 2.0% | 1.9% | 2.2% | 2.5% | 2.0% | 2.8% | 3.5% | 2.6% |

Chesapeake’s price-to-earnings ratio has declined since our last update, due to higher earnings estimates and a lower share price. Shares now go for 5.7 times projected earnings, versus our fair value estimate of 8.5 times earnings. With the stock at just 67% of our estimate of fair value, we forecast a modest tailwind in the coming years from the valuation. We see the yield declining somewhat as the valuation rises, the dividend grows, and our price target is \$30. Chesapeake’s valuation is based upon a relatively low base of earnings for 2023.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 18% | 23% | 21% | 23% | 20% | 18% | 21% | 21% | 17% | 16% | 20% | 22% |

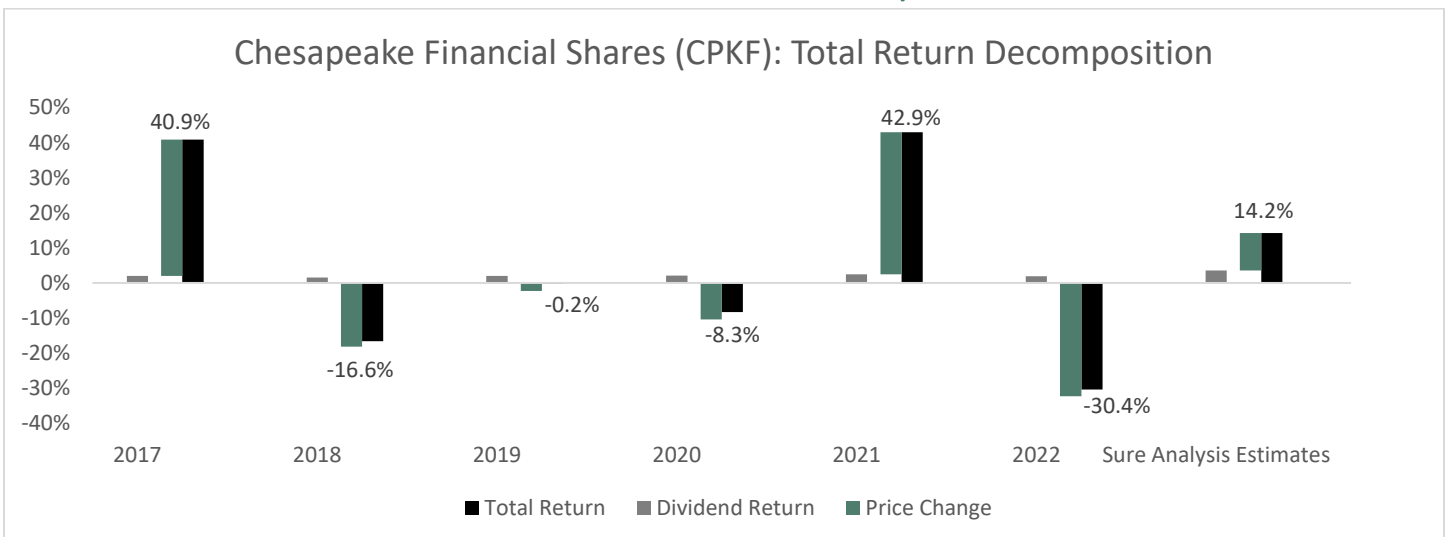
Chesapeake’s payout ratio has always been very low, and we expect it will remain as such in the coming years. The good news is that the streak of dividend increases should be safe in just about any environment, since even an enormous decline in earnings should allow Chesapeake to continue boosting the 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, and is again.

Final Thoughts & Recommendation

Chesapeake’s fundamentals are strong at this point. The stock is undervalued in our view, but we’ve reduced our earnings estimate for 2023. We expect total annual returns of 14.2% for the next five years, consisting of the current 3.5% yield, 3% growth, and an 8.4% tailwind from the valuation. We are reiterating the stock at a buy rating following third quarter results.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|----------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue | 37 | 35 | 38 | 40 | 44 | 45 | 49 | 52 | 57 | 65 |
| SG&A Exp. | 17 | 18 | 20 | 21 | 22 | 24 | 26 | 27 | 30 | 28 |
| D&A Exp. | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 |
| Net Profit | 7 | 7 | 7 | 7 | 9 | 11 | 11 | 12 | 15 | 18 |
| Net Margin | 19.9% | 18.8% | 19.7% | 17.8% | 20.3% | 23.8% | 23.2% | 22.5% | 25.2% | 27.7% |
| Free Cash Flow | 13 | 16 | 4 | 10 | 13 | 14 | 10 | 4 | 21 | 25 |
| Income Tax | 2 | 1 | 1 | 1 | 2 | 1 | 2 | 2 | 2 | 3 |

Balance Sheet Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|----------------------|------|------|------|------|------|------|------|-------|-------|-------|
| Total Assets | 663 | 663 | 679 | 721 | 785 | 855 | 958 | 1,205 | 1,386 | 1,329 |
| Cash & Equivalents | 60 | 27 | 15 | 13 | 18 | 48 | 49 | 70 | 21 | 26 |
| Total Liabilities | 601 | 593 | 603 | 643 | 698 | 762 | 853 | 1,082 | 1,259 | 1,250 |
| Accounts Payable | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Long-Term Debt | 26 | 21 | 31 | 26 | 15 | 5 | 5 | 55 | 124 | 71 |
| Shareholder's Equity | 62 | 71 | 76 | 78 | 87 | 93 | 105 | 123 | 126 | 79 |
| LTD/E Ratio | 0.42 | 0.29 | 0.41 | 0.34 | 0.17 | 0.06 | 0.05 | 0.45 | 0.98 | 0.90 |

Profitability & Per Share Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|------------------|-------|------|-------|------|-------|-------|-------|-------|-------|-------|
| Return on Assets | 1.1% | 1.0% | 1.1% | 1.0% | 1.2% | 1.3% | 1.3% | 1.1% | 1.2% | 1.3% |
| Return on Equity | 12.0% | 9.9% | 10.1% | 9.1% | 10.9% | 12.1% | 11.5% | 10.3% | 12.1% | 17.2% |
| ROIC | 7.8% | 7.3% | 7.5% | 6.7% | 8.7% | 10.8% | 10.9% | 8.1% | 7.0% | 8.8% |
| Shares Out. | 3.3 | 4.0 | 4.0 | 4.0 | 4.1 | 4.1 | 4.9 | 4.9 | 4.8 | 4.7 |
| Revenue/Share | 7.73 | 7.17 | 7.67 | 8.01 | 8.90 | 9.13 | 9.86 | 10.65 | 12.34 | 13.81 |
| FCF/Share | 2.65 | 3.26 | 0.74 | 1.96 | 2.64 | 2.86 | 1.96 | 0.88 | 4.42 | 5.34 |

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

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