



# Chesapeake Financial Shares (CPKF)

Updated July 26<sup>th</sup>, 2024, by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$18	<b>5 Year CAGR Estimate:</b>	10.9%	<b>Market Cap:</b>	\$84 M
<b>Fair Value Price:</b>	\$21	<b>5 Year Growth Estimate:</b>	5.0%	<b>Ex-Dividend Date:</b>	09/01/24 <sup>1</sup>
<b>% Fair Value:</b>	86%	<b>5 Year Valuation Multiple Estimate:</b>	3.0%	<b>Dividend Payment Date:</b>	09/15/24
<b>Dividend Yield:</b>	3.4%	<b>5 Year Price Target</b>	\$27	<b>Years Of Dividend Growth:</b>	31
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	A	<b>Rating:</b>	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 \$84 million, and it produces just over \$60 million in annual revenue. Chesapeake has also boosted its dividend for 31 consecutive years, although it is too small to be a Dividend Aristocrat. The bank has \$1.5 billion in total assets.

Chesapeake posted second quarter earnings on July 23<sup>rd</sup>, 2024, and results were about equal to what we saw a year ago. Earnings came to \$3.037 million, which was equal to a year ago. Reported earnings-per-share came to 64.6 cents, which was off fractionally from 64.8 cents a year ago.

Total assets came to \$1.533 billion, up \$62 million from year-end. Nonperforming assets were 0.237%, which was much better than 0.327% a year ago.

Management noted the spike in interest rates from the past couple of years has continued to put pressure on net interest margin, but that the bank is seeing improvement there.

We have boosted our estimate of earnings-per-share to \$2.45 following Q2 results, although we note that earnings estimates are still very far off from 2022 levels.

## Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
<b>EPS</b>	\$1.65	\$1.85	\$1.75	\$2.17	\$2.17	\$2.29	\$2.40	\$3.11	\$3.73	\$2.15	<b>\$2.45</b>	<b>\$3.13</b>
<b>DPS</b>	\$0.38	\$0.39	\$0.41	\$0.43	\$0.46	\$0.49	\$0.50	\$0.53	\$0.58	\$0.61	<b>\$0.62</b>	<b>\$0.79</b>
<b>Shares<sup>2</sup></b>	4.0	4.0	4.0	4.1	4.1	4.9	4.9	4.9	4.7	4.7	<b>4.7</b>	<b>4.7</b>

Chesapeake successfully navigated the Great Recession, but growth since earnings normalized has been fairly weak at ~5% annually. We are estimating growth of 5% annually as the expected base of earnings is now lower than before, as loan growth is picking up with Chesapeake taking advantage of higher lending rates, which should also bring margin improvements. Chesapeake'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, with some of that being evident in year-to-date 2024 results. Credit quality is holding up nicely, but management is somewhat cautious. 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 79 cents over the next five years. Indeed, Chesapeake has boosted its dividend for 31 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.

<sup>1</sup> Estimated date

<sup>2</sup> 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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	9.0	8.9	11.5	12.0	11.4	9.8	8.4	8.6	5.5	8.5	7.3	8.5
Avg. Yld.	3.0%	2.9%	2.4%	2.0%	1.9%	2.2%	2.5%	2.0%	2.8%	3.3%	3.4%	3.0%

Chesapeake's price-to-earnings ratio after Q1 earnings is now 7.3, versus our fair value estimate of 8.5 times earnings. With the stock at 86% 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 \$27. Chesapeake's valuation is based upon a relatively low base of earnings for 2024.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	23%	21%	23%	20%	18%	21%	21%	17%	16%	28%	25%	25%

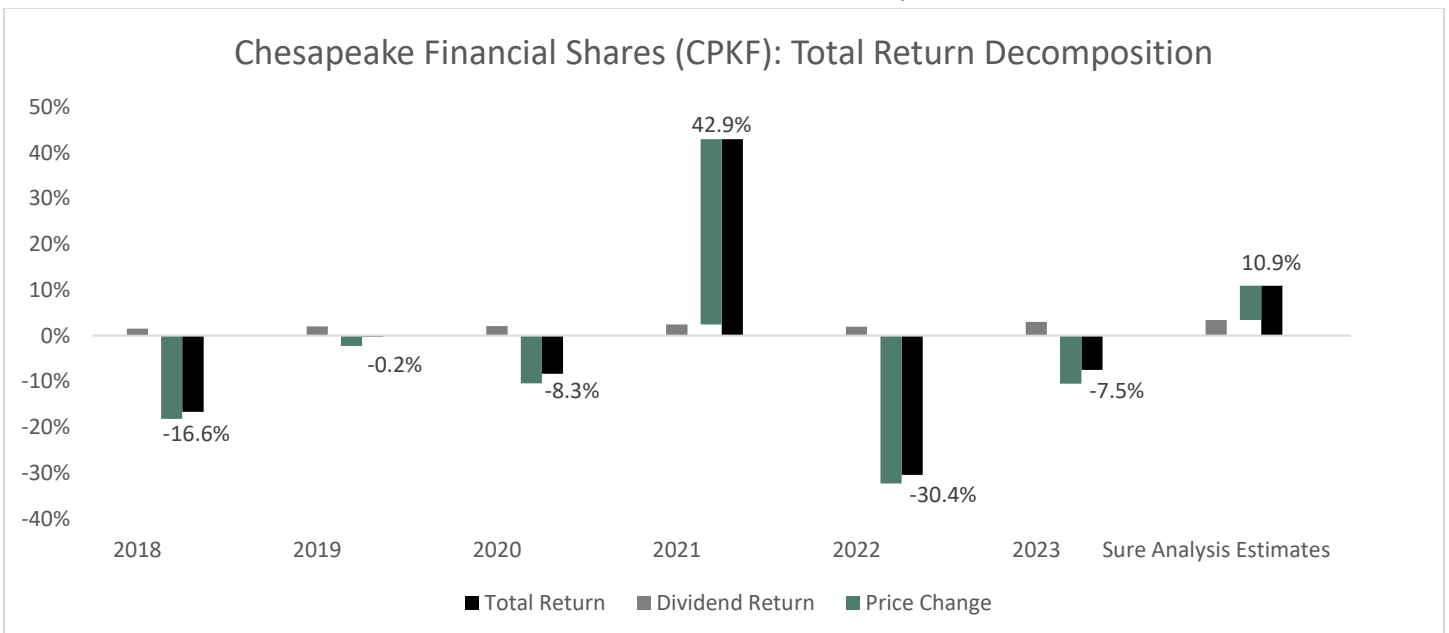
Chesapeake's payout ratio has always been very low, and we expect it will remain as such in the coming years. The good news is that the streak of dividend increases should be safe in just about any environment, since even an enormous decline in earnings should allow Chesapeake to continue boosting the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

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 despite low earnings. The stock is undervalued in our view, but we continue to see low earnings for 2024. We expect total annual returns of 10.9% for the next five years, consisting of the current 3.4% yield, 5% growth, and a 3% tailwind from the valuation. We are reiterating the stock at a buy rating following second quarter results.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	35	38	40	44	45	49	52	57	65	63
SG&A Exp.	18	20	21	22	24	26	27	30	28	31
D&A Exp.	2	2	2	2	2	2	2	2	2	2
Net Profit	7	7	7	9	11	11	12	15	18	10
Net Margin	18.8%	19.7%	17.8%	20.3%	23.8%	23.2%	22.5%	25.2%	27.7%	15.9%
Free Cash Flow	16	4	10	13	14	10	4	21	25	12
Income Tax	1	1	1	2	1	2	2	2	3	2

## Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	663	679	721	785	855	958	1,205	1,386	1,329	1,471
Cash & Equivalents	27	15	13	18	48	49	70	21	26	69
Total Liabilities	593	603	643	698	762	853	1,082	1,259	1,250	1,373
Accounts Payable	0	0	0	0	0	0	0	0	0	1
Long-Term Debt	21	31	26	15	5	5	55	124	71	88
Shareholder's Equity	71	76	78	87	93	105	123	126	79	99
LTD/E Ratio	0.29	0.41	0.34	0.17	0.06	0.05	0.45	0.98	0.90	0.89

## Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	1.0%	1.1%	1.0%	1.2%	1.3%	1.3%	1.1%	1.2%	1.3%	0.7%
Return on Equity	9.9%	10.1%	9.1%	10.9%	12.1%	11.5%	10.3%	12.1%	17.2%	11.4%
ROIC	7.3%	7.5%	6.7%	8.7%	10.8%	10.9%	8.1%	7.0%	8.8%	6.0%
Shares Out.	4.0	4.0	4.0	4.1	4.1	4.9	4.9	4.8	4.7	4.7
Revenue/Share	7.17	7.67	8.01	8.90	9.13	9.86	10.65	12.34	13.81	13.35
FCF/Share	3.26	0.74	1.96	2.64	2.86	1.96	0.88	4.42	5.34	2.57

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

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