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Chesapeake Financial Shares, Inc. (CPKF – OTCQB)

John A. Howard, CFA
February 3, 2015

Price: *	$ 15.51	**Diluted EPS**	**2013A:**	$1.84	**P/E**	**2013A:**	8.4 x
52 Wk. Range:	$14.08 - $16.66	(FY: DEC)	**2014A:**	$1.62		**2014A:**	9.6 x
Div/Div Yld:	$0.45 /2.9%		**2015E:**	$1.54		**2015E:**	10.1 x
Shrs/Mkt Cap:	4.0 mm/ $62 mm	**Book Value:**		$17.71	**Price/Book Value:**		0.88 x

* All per share figures have been adjusted for the 6-for-5 stock dividend paid in October 2014.

SYMBOL: CPKF

ASSETS: $663 MM

HQ: KILMARNOCK, VA

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Background

Chesapeake Financial Shares, Inc. is a one-bank holding company originally chartered in 1900 and is based in Kilmarnock, VA. As of December 31, 2014, the Company had $663 million in total assets. The holding company operates two subsidiaries, Chesapeake Bank and Chesapeake Investment Group, Inc. Chesapeake Bank is primarily a lender to small businesses. Personal and business products and services offered include checking, savings, CDs, mortgages, mobile and online banking, e-services comprising an internet branch, and a business cash management program. The Bank currently operates 12 branches; four in the Northern Neck, three in the Middle Peninsula, and five in Williamsburg. The Bank also offers merchant processing services for credit and debit card transactions. A loan production office was opened in Richmond, VA, in 2011. Chesapeake Investment Group is an independent wealth management firm with more than $340 million in assets which offers trust and estate management services. Chesapeake Financial Shares, Inc.'s stock trades on the over-the-counter market (OTCQB) under the symbol "CPKF." The Company's Chairman, President, and CEO, Jeffrey M. Szyperski, is a former Chairman of the Virginia Bankers Association and was appointed in 2014 to the ABA Board of Directors for a three-year term.

4TH QUARTER HIGHLIGHTS:

EPS: $0.41 VS. $0.30

NET INTEREST INCOME INCREASED 2%

NONINTEREST INCOME DECLINED, THOUGH THE PROFITABILITY OF THE KEY AREAS IMPROVED

NONINTEREST EXPENSE DECREASED 2%

Earnings in the Fourth Quarter Increased 36%

Chesapeake Financial Shares reported excellent fourth quarter results. Earnings were well above the year-ago figures and reflected higher net interest income (partly from margin improvement), a drop in the provision for loan losses (thanks to improving asset quality) and solid cost containment. As a result of the improved earnings, Chesapeake's profitability ratios improved significantly from the year-ago level and, as is discussed more fully on the opposite page, remain well above the Company's peers.

Earnings in the fourth quarter of 2014 were $1,640,000, or $0.41 per diluted share, up 36% from $1,203,000, or $0.30 per diluted share, in the year-ago quarter. Net interest income increased 2% to $5,974,000 in the fourth quarter of 2014 from $5,863,000 in the year-ago quarter, with an increase in the net interest margin more than offsetting a modest drop in average earning assets. Noninterest income, excluding impairment losses and securities gains, decreased 7% to $3,807,000 for 2014's fourth quarter from $4,109,000 in the year-ago quarter, though on a linked quarter basis it increased about 2%. Although noninterest income did drop in the quarter, it is important to note that the *profitability* in each of the key areas (Merchant Card, ATM and Cash Flow) increased in 2014's fourth quarter relative to the year-ago quarter, providing ongoing evidence that the efficiency of each operation is being actively managed. That progress in efficiency was also evident in the Company's total noninterest expense, which in aggregate was down 2% to $8,207,000 in the fourth quarter of 2014 from $8,407,000 in the year-ago quarter. Lower losses on OREO also contributed to this expense reduction. As a final note on the quarter, we would mention that the provision for loan losses was lower in the fourth quarter of 2014, at $150,000, versus the year-ago quarter of $283,000.

Chesapeake's Profitability Ratios Improved Significantly and Are Superior to VA Peers

As was stated previously, the strong fourth quarter earnings boosted Chesapeake's profitability ratios, as can be seen in the table below. Moreover, these figures are better than the majority of the Company's VA peers. For example, Chesapeake's annualized return on average assets was 0.99% in 2014's fourth quarter, up from 0.72% in the year-ago quarter and versus 0.81% for the VA peer group median. The annualized return on average equity increased to 9.92% in the fourth quarter of 2014 from 7.84% in the year-ago quarter, and as compared to 8.05% for the VA peer group median. The margin increased 18 basis points to 4.08% in 2014's fourth quarter, from 3.90% in the year-ago quarter, and was better than 3.84% for the peer median. We would also note that despite these superior profitability ratios, CPKF shares are trading at a discount to the peer group on both a multiple of latest twelve months earnings (9.6x versus 13.0x for the peer median) and book value (0.88x versus 0.96x for the peer median).

THE ROAA, ROAE AND MARGIN INCREASED SIGNIFICANTLY AND WERE SUPERIOR TO THE PEER GROUP MEDIANS

MOREOVER, CPKF SHARES TRADE BELOW THE PEER MEDIAN ON BOTH A P/E AND PRICE/BOOK VALUE BASIS

PROFITABILITY IMPROVEMENT AND PEER GROUP COMPARISONS (%, EXCEPT MULTIPLES)

	CPKF Q4 13	CPKF Q4 14	VA Peer Group Median
ROAA	0.72	0.99	0.81
ROAE	7.84	9.92	8.05
Net Int. Mrgn.	3.90	4.08	3.84
P/E Ratio		9.6x	13.0x
P/BV Ratio		0.88x	0.96x

TWELVE-MONTH HIGHLIGHTS:

EPS: $1.62 VS. $1.84

EARNINGS DECREASED PARTLY DUE TO NONRECURRING FACTORS

For the twelve months ended December 31, 2014, net income totaled $6,534,000, or $1.62 per diluted share, versus $7,353,000, or $1.84 per diluted share, in the year-ago period. Part of that decline was due to substantially higher security gains in 2013, though a lower provision for loan losses in 2014 offset some of the drop in security gains. Net interest income was relatively flat, while noninterest income, excluding nonrecurring items, was down 2% and noninterest expense increased 3% in 2014 relative to 2013.

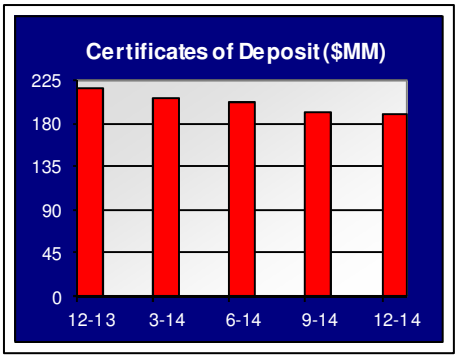
While Balance Sheet Growth Has Been Modest, Mix is Improving

Although balance sheet growth was modest over the past year, Chesapeake has been making progress in terms of balance sheet mix. For example, while deposits were down 2% over the past year, the decrease was primarily due to a roll off of higher cost certificates of deposit, as can be seen in the chart at the right. At the same time, loans (a higher yielding asset) have increased as a percentage of assets, while lower yielding cash and investments have dropped. The Company remains well capitalized, with shareholders' equity of $71 million (10.65% of total assets) at December 31, 2014, up from $62 million (9.33% of total assets) at the year-ago date.

CERTIFICATES OF DEPOSIT DECREASED 13%, AND DECLINED AS A PERCENTAGE OF TOTAL DEPOSITS

LOANS HAVE INCREASED AS A PERCENTAGE OF AVERAGE EARNING ASSETS

EQUITY/ASSETS: 10.65%



Nonperforming Assets Declined 42% from the Year-Ago Date

Asset quality also improved at year-end 2014. NPAs totaled $11.1 million, or 1.68% of total assets, at December 31, 2014, down 13% from $12.8 million, or 1.95% of total assets, at September 30, 2014, and down 42% from $19.1 million, or 2.90% of total assets, at the year-ago date. The allowance for loan losses was $6.4 million (1.63% of total loans) at December 31, 2014, compared to $6.3 million (1.66% of total loans) at the year-ago date.

NPAS/ASSETS: 1.68%

RESERVES/LOANS: 1.63%

Projections Maintained

Although recent earnings were better than expected, we are leaving our 2015 earnings estimate unchanged at $6.2 million, or $1.54 per share. These projections could vary considerably if economic or other conditions change.

EPS:
2013A: $1.84
2014A: $1.62
2015E: $1.54

ADDITIONAL INFORMATION UPON REQUEST

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