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Chesapeake Financial Shares, Inc. (CPKF – PINK SHEETS)

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July 20, 2010

Price:	\$ 13.20	EPS *	2009A:	\$1.77	P/E	2009A:	7.5 x
52 Wk. Range:	\$12.10 - \$15.87	(FY: DEC)	2010E:	\$1.80		2010E:	7.3 x
Div/Div Yld:	\$0.44 / 3.3%		2011E:	\$1.88		2011E:	7.0 x
Shrs/Mkt Cap:	2.7 mm/ \$36 mm	Book Value:		\$13.99	Price/Book Value:		0.94 x

• Diluted.

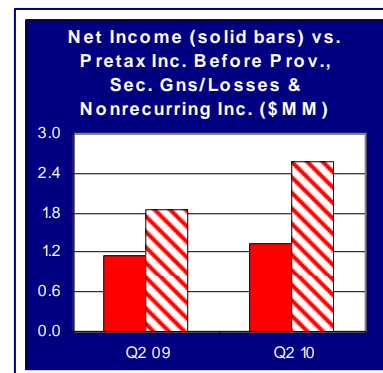
Background

With approximately \$604 million in assets as of June 30, 2010, Chesapeake Financial Shares, Inc. is a one-bank holding company that is based in Kilmarnock, Virginia. The Company has two subsidiaries: 1) Chesapeake Bank, a full-service, state-chartered commercial bank whose origins trace back to 1900, and 2) Chesapeake Investment Group, Inc., through which wealth management services are provided, including trust, asset management and brokerage. Chesapeake Bank offers these and other financial services through an on-line office, 11 retail locations and 13 ATMs. Additional services include Touch Tone Teller, a 24-hour banking service, and Internet-based Online Banking, Internet Bill Pay and Easy Deposit (remote capture). Chesapeake Bank serves a market area in Eastern Virginia defined to the north by the Potomac River and to the south by the James River. The Bank has four offices in Williamsburg, two in Irvington, and one each in Gloucester, Hayes, Kilmarnock, Lively and Mathews. Chesapeake Financial Shares, Inc.'s common stock trades on the over-the-counter market under the symbol CPKF and is quoted in the Pink Sheets.

Second Quarter EPS Beat Projections by \$0.04

Chesapeake Financial Shares reported solid second quarter results. Earnings were again better than expected, an increase in the cash dividend was announced (something it can readily do given the solid earnings trends, the low dividend payout and the lack of TARP funds) and the Board approved funds to be used to fund stock repurchases, which we view as particularly appropriate given the low earnings multiple of the stock. Additionally, the Company was recognized (for the third year in a row) in *U.S. Banker* magazine's "Top 200 Community Banks" in the U.S.

Net income was \$1.3 million, or \$0.48 per diluted share, in the second quarter of 2010, compared to \$1.2 million, or \$0.41 per diluted share, in the year-ago quarter. From an operating standpoint, the improvement was actually somewhat better than implied by those bottom lines figures, as there were impairment and/or security losses in both quarters (\$0.6 million in 2010's second quarter and \$0.2 million in the year-ago quarter), and the provision for loan losses increased 50% to \$150,000 from \$100,000 over this period. Earnings excluding the securities losses and the provision increased 39% from the year-ago quarter, as can be seen in the chart to the right. The strong earnings growth was mainly attributable to net interest income, which increased 22%. The Bank is still deriving significant benefits from the re-pricing of deposits, most particularly CDs. There should be another quarter or so of improvement, as interest costs on CDs were still relatively high in the third quarter of 2009 (\$1.6 million), relative to the current quarter cost of \$1.2 million on a higher average balance. Noninterest income, excluding securities losses, also improved, growing 3% to \$3.7 million in the second quarter of 2010 from \$3.6 million in the year-ago



SYMBOL: CPKF

ASSETS: \$604 MM

HQ: KILMARNOCK, VA

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2ND QUARTER HIGHLIGHTS:

**NET INCOME INCREASED 15%,
OR 17% ON AN EPS BASIS**

EPS: \$0.48 vs. \$0.41

**PRETAX INCOME BEFORE THE
PROVISION AND SECURITIES
GAINS/LOSSES INCREASED 39%**

**NET INTEREST INCOME GREW
22%**

**NONINTEREST INCOME WAS UP
3% EXCLUDING SECURITY
LOSSES**

quarter. Finally, noninterest expense had a modest increase of 6% to \$6.7 million in 2010's second quarter from \$6.3 million in the year-ago quarter.

FIRST HALF HIGHLIGHTS:

EPS: \$0.91 vs. \$0.74

EPS INCREASED 22%

Six month results pretty much mirrored the quarterly results, with EPS up 22% to \$0.91 per diluted share \$0.74 per diluted share in the year-ago period. As with the quarter, the earnings increase was achieved despite significant growth in the provision for loan losses, which totaled \$392,000, up 57% from the year-ago level.

CHESAPEAKE'S EQUITY BUILD-UP RATE IS MORE THAN 10%, WHICH IS AMONG THE HIGHEST OF ANY BANK WE CURRENTLY FOLLOW

High Equity "Build Up" Rate Supports Capital Ratio

Although balance sheet growth was in the single-digits over the past year, recent sequential growth has been fairly flat, which is actually a positive in that it: 1) puts less pressure on the Bank to boost the provision and 2) allows the capital ratios to expand, given Chesapeake's strong equity build-up rate. [This equity build-up rate can be measured by multiplying the ROAE (14.2% in 2010's second quarter) times one minus the dividend payout ratio (roughly 25%) to arrive at 10.7%]. That is a much higher rate than for most of the banks we follow, and again, it better positions the Company from a capital standpoint. As of June 30, 2010, shareholders' equity totaled \$38 million, or 6.3% of total assets.

FUNDS HAVE BEEN ALLOTTED FOR THE REPURCHASE OF SHARES

Funds Allocated for Stock Repurchase, Dividend Increased, "Top 200" Community Bank Award

In two steps that were particularly notable (especially given the fact that TARP banks can't do either of these), Chesapeake's Board of Directors approved \$186,000 in funds to repurchase shares in the open market. They also voted to increase the quarterly dividend to \$0.11 per share in September. In our view, the stock buyback is a particularly compelling idea, and we applaud the Board for approving it. With the stock trading at roughly 7.5x earnings, it equates to the Company getting 13.3% after-tax return on its money, and the after-tax cash return is the current dividend yield of 3.3%, or 4.6% on a pretax equivalent basis. Furthermore, buying below the book value of \$13.99 increases the book value of the remaining shares. The fact that the Company also increased the cash dividend is significant, not only in that it signals Board confidence in the operating results, but also in that it perpetuates a long-standing dividend record: ten increases in ten years. Chesapeake's strong record has not gone unnoticed, as the Company was named one of the "Top 200 Community Banks" in the nation by *U.S. Banker* magazine for the third year in a row. The ranking is based on a bank's three-year average return on equity for approximately 6,000 U.S. community banks. Based on its three-year average return on equity of 13.44%, Chesapeake ranked number 32 of all the banks, which was up from number 64 in 2009 and number 148 in 2008. The Company's ROAE also compares favorably to its Virginia peers, as its ROAE was the highest of the 28 banks in its VA peer group, which included banks with assets between \$250 million and \$1 billion.

QUARTERLY DIVIDEND WILL INCREASE TO \$0.11 PER SHARE

THE BANK WAS NAMED TO THE TOP 200 BANKS IN THE NATION BY U.S. BANKER MAGAZINE AND MOVED UP IN RANK

CPKF'S ROAE IS THE HIGHEST OF ITS VA PEER GROUP

Asset Quality Remains Good

While nonperforming assets increased at June 30, 2010 to \$11.2 million (or 1.86% of total assets), from \$9.0 million, or 1.48% of total assets, at March 31, 2010 and \$2.6 million, or 0.46% of total assets, at the year-ago date, it is important to note that asset quality ratios still compare favorably to the Company's NPAs-to-assets peer median ratio of 2.12%. Further, reserves as a percentage of loans have been steadily improving over the past year, reaching 1.49% at June 30, 2010, versus 1.34% at the year-ago date. The reserves-to-loans ratio also was better than the VA peer group median of 1.45%.

NPAs/ASSETS: 1.86%

RESERVES/LOANS: 1.49%

Projections Increased

Given that Chesapeake outperformed our projections, we are slightly increasing our 2010 earnings estimate to \$4.9 million, or \$1.80 per diluted share, from \$4.8 million, or \$1.76 per diluted share, projected previously. For 2011, we are projecting earnings will be \$5.2 million, or \$1.88 per diluted share. For more information about Chesapeake Financial Shares, please visit the Company's web site at www.chesbank.com.

**EPS:
2009A: \$1.77
2010E: \$1.80
2011E: \$1.88**

ADDITIONAL INFORMATION UPON REQUEST

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