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CHESAPEAKE FINANCIAL SHARES INC

Form 10-Q

August 13, 2001

U.S. Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15 (D) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2001

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT
For the transition period from _____ to _____

Commission file number 0-18543

CHESAPEAKE FINANCIAL SHARES, INC.

(Exact name of registrant as specified in its charter)

Virginia

54-1210845

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

97 N. Main St., Kilmarnock, VA 22482

(Address of principal executive offices) (Zip Code)

(804) 435-1181

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last
report.)

Indicate by check mark whether the registrant (1) has filed all reports required
to be filed by Section 12, 13 or 15(d) of the Securities and Exchange Act of
1934 during the preceding 12 months (or for such shorter period that the
registrant was required to file such reports), and (2) has been subject to such
filing requirements for the past 90 days. Yes X No

Indicate the number of shares outstanding of each of the issuer's
classes of common stock as of August 1, 2001.

| Class ----- | Outstanding at August 1, 2001 ----- |
|--|--|
| Common Stock, voting, \$5.00 par value | 1,247,960 |
| Common Stock, non-voting, \$5.00 par value | 0 |

CHESAPEAKE FINANCIAL SHARES, INC.

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FORM 10-QSB

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| Chesapeake Financial Shares, Inc. Consolidated Balance Sheets | June 30, 2001 | December 31, 2000 |
|---|------------------|----------------------|
| ASSETS | | |
| | (Unaudited) | |
| Cash and due from banks..... | \$ 10,043,053 | \$ 8,965,457 |
| Federal funds sold..... | 6,047,000 | 0 |
| Securities available for sale | | |
| U.S. Government agencies (book value of \$18,226,219 -2001 and \$21,053,805-2000)..... | 18,624,760 | 21,167,667 |
| Obligations of state and political subdivisions (book value of \$14,692,998-2001 and \$15,110,437-2000)..... | 16,026,327 | 15,839,088 |
| Other Securities (book value \$2,294,661-2001 and \$2,551,294-2000)..... | 2,306,100 | 2,548,600 |
| Loans..... | 163,962,453 | 158,455,860 |
| Less: Reserve for loan loss..... | (2,435,590) | (2,125,022) |
| Net loans..... | 161,526,863 | 156,330,838 |
| Bank premises and equipment, net..... | 5,279,135 | 5,580,409 |
| Accrued interest receivable..... | 1,485,124 | 1,533,719 |
| Business Manager Assets..... | 10,264,618 | 9,209,373 |
| Other assets..... | 2,830,439 | 3,037,565 |
| Total assets..... | \$ 234,433,419 | \$ 224,212,716 |

See accompanying notes to consolidated financial statements. Page: 1

PART I. Item 1. - FINANCIAL INFORMATION

| Chesapeake Financial Shares, Inc. Consolidated Balance Sheets | June 30, 2001 | December 31, 2000 |
|--|------------------|----------------------|
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| | (Unaudited) | |
| Deposits | | |
| Noninterest bearing deposits..... | \$ 30,652,013 | \$ 27,396,972 |
| Savings and interest bearing deposits..... | 70,986,199 | 64,744,254 |
| Certificates of deposit..... | 100,529,810 | 101,902,570 |
| Total deposits..... | 202,168,022 | 194,043,796 |
| Federal funds purchased and FHLB advances..... | 10,000,000 | 9,500,000 |
| Accrued interest payable..... | 321,204 | 397,244 |
| Other liabilities..... | 1,532,114 | 1,119,597 |
| Note payable..... | 807,046 | 821,762 |
| Total liabilities..... | 214,828,386 | 205,882,399 |
| Commitments and contingent liabilities | | |
| Shareholders' equity | | |
| Preferred stock, par value \$1 per share; authorized 50,000 shares; none outstanding..... | 0 | 0 |
| Common stock, voting, par value \$5..... | 6,239,800 | 6,149,200 |

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| | | | | |
|---|-----------|-----------|---------------|---------------|
| Common stock, non-voting..... | | | 0 | 0 |
| | voting | | non-voting | |
| | 6/30/01 | 12/31/00 | 6/30/01 | 12/31/00 |
| | ----- | ----- | ----- | ----- |
| Shares auth. 2,400,000 | 2,400,000 | 2,400,000 | 635,000 | 635,000 |
| Shares o/s 1,247,960 | 1,247,960 | 1,229 | 0 | 0 |
| Paid in capital..... | | | 172,771 | 153,521 |
| Accumulated other comprehensive income..... | | | 727,280 | 554,280 |
| Retained earnings..... | | | 12,465,182 | 11,473,316 |
| | | | ----- | ----- |
| Total shareholders' equity..... | | | 19,605,033 | 18,033,317 |
| | | | ----- | ----- |
| Total liabilities and Shareholders' equity..... | | | \$234,433,419 | \$224,212,716 |
| | | | ===== | ===== |

See accompanying notes to consolidated financial statements. Page: 2

PART I. Item 1. - FINANCIAL INFORMATION (cont'd.)

Chesapeake Financial Shares, Inc.
Consolidated Statements of Earnings

Three Months
June 30,
2001 2

| | | |
|--|-------------|-------------|
| Interest Income | | (Unaudited) |
| Interest and fees on loans..... | \$3,722,515 | \$3,1 |
| Interest on federal funds sold..... | 29,523 | |
| Interest on time deposits with banks..... | 6,631 | |
| Interest on U.S. Agency Obligations..... | 329,195 | 3 |
| Interest on obligations of state and political subs..... | 217,297 | 2 |
| | ----- | |
| Total interest income..... | 4,305,161 | 3,8 |
| Interest Expense | | |
| Interest on savings and interest bearing deposits..... | 417,238 | 5 |
| Interest on certificates of deposit..... | 1,469,741 | 1,1 |
| Interest on federal funds purchased..... | 100,633 | 1 |
| Other interest expense..... | 11,165 | |
| | ----- | |
| Total interest expense..... | 1,998,777 | 1,8 |
| Net interest income..... | 2,306,384 | 1,9 |
| Provision for loan losses..... | 127,666 | 1 |
| | ----- | |
| Net interest income after provision for loan losses..... | 2,178,718 | 1,8 |
| | ----- | |
| Noninterest Income | | |
| Income from fiduciary activities..... | 255,035 | 2 |
| Service charges on deposit accounts..... | 216,975 | 1 |
| Merchant card income..... | 230,834 | 2 |
| ATM income..... | 69,358 | |
| Cash Management income..... | 453,325 | 3 |
| Other income..... | 171,321 | 1 |
| | ----- | |
| Total noninterest income..... | 1,396,848 | 1,2 |

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| Noninterest Expense | | |
|--|------------|------|
| Salaries..... | 1,084,657 | 8 |
| Employee benefits..... | 178,615 | 1 |
| Occupancy expenses..... | 473,343 | 3 |
| Merchant card expense..... | 225,936 | 2 |
| ATM expense..... | 59,269 | |
| Cash management expense..... | 138,310 | 1 |
| Other expenses..... | 527,606 | 5 |
| <hr/> | | |
| Total noninterest expense..... | 2,687,736 | 2,4 |
| <hr/> | | |
| Income before income taxes..... | 887,830 | 6 |
| Income taxes..... | 244,879 | 1 |
| <hr/> | | |
| Net income..... | \$ 642,951 | \$ 4 |
| <hr/> | | |
| Earnings per share, basic..... | \$ 0.52 | \$ |
| Earnings per share, assuming dilution..... | \$ 0.51 | \$ |

See accompanying notes to consolidated financial statements. Page: 3

PART I. Item 1. - FINANCIAL INFORMATION (cont'd.)

Chesapeake Financial Shares, Inc.
Consolidated Statements of Earnings

Six Months Ended
June 30,
2001 2000

| Interest Income | (Unaudited) | |
|--|--------------|--------------|
| Interest and fees on loans..... | \$ 7,411,679 | \$ 6,160,705 |
| Interest on federal funds sold..... | 30,017 | 2,060 |
| Interest on time deposits with banks..... | 14,263 | 8,876 |
| Interest on U.S. Agency Obligations..... | 684,048 | 793,150 |
| Interest on obligations of state and political subs..... | 453,860 | 502,106 |
| <hr/> | | |
| Total interest income..... | 8,593,867 | 7,466,897 |
| <hr/> | | |
| Interest Expense | | |
| Interest on savings and interest bearing deposits..... | 910,506 | 1,104,869 |
| Interest on certificates of deposit..... | 2,998,548 | 2,236,078 |
| Interest on federal funds purchased..... | 228,113 | 230,077 |
| Other interest expense..... | 22,431 | 19,321 |
| <hr/> | | |
| Total interest expense..... | 4,159,598 | 3,590,345 |
| <hr/> | | |
| Net interest income..... | 4,434,269 | 3,876,552 |
| Provision for loan losses..... | 322,666 | 180,248 |
| <hr/> | | |
| Net interest income after provision for loan losses..... | 4,111,603 | 3,696,304 |
| <hr/> | | |

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Noninterest Income

| | | |
|--|-----------|-----------|
| Income from fiduciary activities..... | 474,704 | 459,456 |
| Service charges on deposit accounts..... | 414,200 | 325,853 |
| Security gains (losses) - net..... | (1,625) | 0 |
| Merchant card income..... | 425,778 | 407,597 |
| ATM income..... | 124,744 | 114,350 |
| Cash Management income..... | 890,046 | 738,322 |
| Other income..... | 321,387 | 286,615 |
| | | |
| Total noninterest income..... | 2,649,234 | 2,332,193 |
| | | |

Noninterest Expense

| | | |
|---------------------------------|--------------|--------------|
| Salaries..... | 1,975,509 | 1,720,065 |
| Employee benefits..... | 395,905 | 363,224 |
| Occupancy expenses..... | 856,888 | 773,213 |
| Merchant card expense..... | 387,047 | 374,342 |
| ATM expense..... | 117,644 | 119,263 |
| Cash management expense..... | 285,762 | 343,897 |
| Other expenses..... | 1,036,161 | 1,016,281 |
| | | |
| Total noninterest expense..... | 5,054,916 | 4,710,285 |
| | | |
| Income before income taxes..... | 1,705,921 | 1,318,212 |
| Income taxes..... | 441,066 | 316,371 |
| | | |
| Net income..... | \$ 1,264,855 | \$ 1,001,841 |
| | | |

| | | |
|--|---------|---------|
| Earnings per share, basic..... | \$ 1.02 | \$ 0.82 |
| Earnings per share, assuming dilution..... | \$ 1.00 | \$ 0.79 |

See accompanying notes to consolidated financial statements. Page: 4

Chesapeake Financial Shares, Inc. Consolidated Statements of Cash Flows

Six

2001

(Unau

| | |
|---|-----------|
| Cash flows from operating activities: | |
| Net income..... | \$ 1,264, |
| Adjustments to reconcile net income to net cash provided by (used for) operating activities: | |
| Depreciation and amortization..... | 498, |
| Provision for loan losses..... | 322, |
| Provision for cash management account losses..... | 120, |
| (Accretion) of discount and amortization of premiums, net..... | 150, |
| Net loss on sale of securities..... | 1, |
| Changes in assets and liabilities: | |
| Decrease (increase) in accrued interest receivable..... | 48, |
| Decrease (increase) in other assets..... | 118, |
| Increase (decrease) in accrued interest payable..... | (76, |
| Increase (decrease) in other liabilities..... | 412, |
| | |
| Net cash provided by (used for) operating activities..... | 2,861, |

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Cash flows from investing activities:

| | |
|--|---------|
| Purchases of securities available for sale..... | (994, |
| Proceeds from sale or call of securities available for sale..... | 1,038, |
| Proceeds from maturities of securities available for sale..... | 2,664, |
| Origination of loans available for sale..... | 5,032, |
| Proceeds from sale of loans available for sale..... | 5,032, |
| Net (increase) decrease in loans outstanding..... | (5,518, |
| Net (increase) decrease in business manager assets..... | (1,175, |
| Other capital expenditures..... | (197, |
| ----- | |
| Net cash provided by (used for) investing activities..... | (4,182, |
| ----- | |

Cash flows from financing activities:

| | |
|---|---------|
| Net increase (decrease) in demand accounts, interest bearing demand deposit accounts and savings deposits..... | 9,496, |
| Net increase (decrease) in certificates of deposit..... | (1,372, |
| Net increase (decrease) in federal funds purchased..... | 500, |
| Cash dividends..... | (272, |
| Proceeds from issuance of voting common stock..... | 119, |
| Acquisition of voting common stock..... | (9, |
| Curtailement of long-term borrowings..... | (14, |
| ----- | |
| Net cash provided by (used for) financing activities..... | 8,446, |
| ----- | |

| | |
|---|-----------|
| Net (decrease) increase in cash and federal funds sold..... | 7,124, |
| Cash and federal funds sold at beginning of period..... | 8,965, |
| ----- | |
| Cash and federal funds sold at end of period..... | \$16,090, |
| ===== | |

See accompanying notes to consolidated financial statements. Page: 5

Consolidated Statement of Changes in Stockholder's Equity
Chesapeake Financial Shares, Inc.
Six Months Ended June 30, 2000
(unaudited)

| | Total | Comprehensive Income | Retained Earnings | Accumulated Other Comprehensive Income |
|--|--------------|-------------------------|----------------------|---|
| | ----- | ----- | ----- | ----- |
| Beginning balance | \$15,513,452 | | \$ 9,736,920 | \$ (|
| Comprehensive Income: | | | | |
| Net Income | 1,001,841 | \$1,001,841 | 1,001,841 | |
| Other comprehensive income, net of tax: | | | | |
| Unrealized gain on securities available for sale, net of deferred taxes of \$143,295 | 278,161 | 278,161 | | |
| | ----- | ----- | | |

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| | | | | |
|--|-----------------------|----------------------|-----------------------|-----------------|
| Total comprehensive income, net of tax: | | \$1,280,003 ===== | | |
| Acquisition of common stock | (249,666) | | | |
| Issuance of common stock | 110,790 | | | |
| Dividends declared | (233,901) | | (233,901) | |
| | ----- | | ----- | ----- |
| Ending balance | \$16,420,677 ===== | | \$10,504,860 ===== | \$ () ===== |

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Consolidated Statement of Changes in Stockholder's Equity
Chesapeake Financial Shares, Inc.
Six Months Ended June 30, 2001
(unaudited)

| | Total | Comprehensive Income | Retained Earnings | Accum Ot Compre Inc |
|---|-----------------------|-------------------------|-----------------------|------------------------------|
| | ----- | ----- | ----- | ----- |
| Beginning balance | \$18,330,317 | | \$11,473,316 | \$ |
| Comprehensive Income: | | | | |
| Net Income | 1,264,855 | \$1,264,855 | 1,264,855 | |
| Other comprehensive income, net of tax: | | | | |
| Unrealized gain on securities available for sale, net of deferred taxes of \$88,568 | 171,927 | 171,927 | | |
| Add: reclassification adjustment, net of income taxes of \$552 | 1,073 | 1,073 | | |
| | ----- | ----- | | ----- |
| Total comprehensive income, net of tax: | | \$1,437,855 ===== | | |
| Acquisition of common stock | (9,150) | | | |
| Issuance of common stock | 119,000 | | | |
| Dividends declared | (272,989) | | (272,989) | |
| | ----- | | ----- | ----- |
| Ending balance | \$19,605,033 ===== | | \$12,465,182 ===== | \$ ===== |

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PART I. Item 1. - FINANCIAL INFORMATION (cont'd.) 6/01-10QSB
Chesapeake Financial Shares, Inc.
Notes to Consolidated Financial Statements

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1. Chesapeake Financial Shares, Inc. ("CFS") is a Virginia based financial services holding company which traces its roots to a national bank founded in Irvington, Virginia in 1900. The Company has two operating subsidiaries, Chesapeake Bank (the "Bank"), which constitutes the majority of its business activity, and Chesapeake Investment Group, Inc., a newly formed entity which has as its subsidiaries, Chesapeake Financial Group, Inc., Chesapeake Insurance Agency, Inc., d/b/a Chesapeake Investment Services, and Chesapeake Trust Company, Inc. Chesapeake Bank also is the 100% owner of CNB Properties, Inc. The consolidated financial statements include the accounts of CFS and its wholly owned subsidiaries. All significant intercompany accounts have been eliminated.

2. The accounting and reporting policies of the registrant conform to generally accepted accounting principles and to the general practices within the banking industry. The interim financial statements have not been audited; however, in the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the consolidated financial statements have been included.

The results of operations for the three and six months ended June 30, 2001 are not necessarily indicative of the results expected for the full year. These financial statements should be read in conjunction with the financial statements and the footnotes included in the registrant's 2000 Annual Report to Shareholders.

3. The following data shows the amounts used in computing earnings per share and the effect on the weighted average number of shares of potential dilutive common stock. The potential common stock will not have a significant impact on net income.

| | June 30, 2001 | June 30, 2000 |
|--|---------------|---------------|
| | ----- | ----- |
| Weighted average number of common shares, basic | 1,237,720 | 1,229,195 |
| Effect of dilutive stock options | 25,204 | 43,810 |
| | ----- | ----- |
| Weighted number of common shares and dilutive potential common stock used in diluted EPS | 1,262,924 | 1,273,005 |
| | ===== | ===== |

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PART I. Item 2. - FINANCIAL INFORMATION (cont'd.) 6/01-10QSB
 Chesapeake Financial Shares, Inc.
 Management's Discussion and Analysis of Financial
 Condition or Plan of Operation (Unaudited)

A. Summary - liquidity and capital resources

Sufficient short-term assets are maintained at Chesapeake Financial Shares to meet cash needs anticipated by management. Management's primary sources of liquidity continue to be federal funds sold, short term borrowings from Federal Home Loan Bank Atlanta, securities maturing within one year, and principal payments from mortgage securities. The repayment and sale of loans also provides liquidity. The total of federal funds sold, securities maturing within one year, and estimated principal payments on mortgage-backed securities within one year at June 30, 2001 was approximately \$11,595,000, compared to \$4,824,000 one year ago and \$4,034,000 at December 31, 2000. The increase in short term assets was an anomaly at quarter end. Adjusting for the anomaly short term assets at June 30, 2001 would be \$5,548,000.

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The liquidity ratio at June 30, 2001 was 19.7%, compared with 24.6% one year ago. This ratio is arrived at by dividing net liquid assets (sum of total Cash and Due from Banks, including Federal Reserve, unpledged and over pledged portions of Investment Securities at market value, and federal funds sold less reserves required at the Federal Reserve Bank) by net liabilities (total liabilities excluding valuation reserves and capital). Management has found in the past that 18% represents a sufficient level of liquidity to meet cash needs. Lower asset liquidity ratios are to be expected as management has positioned the Company to be more liability liquid to meet the demand for scarce deposits in the current market environment.

Management believes capital is adequate to meet current needs. Unencumbered capital (total capital net of accumulated other comprehensive income less intangibles plus reserves) as a percent of total adjusted assets (total assets less intangibles plus reserves) was 9.0% at June 30, 2001 and 8.7% at December 31, 2000, for CFS.

Chesapeake Financial Shares and Chesapeake Bank must have a ratio of Tier 1 capital (common equity, retained earnings less certain goodwill) to risk-adjusted assets of at least 4.0%. At June 30, 2001 and December 31, 2000 the consolidated ratio of Tier 1 risk-based capital to risk-adjusted assets was 10.1% and 9.1%, respectively. Total risk-based capital to risk weighted assets was 11.3% and 10.3% at June 30, 2001 and December 31, 2000, respectively. Tier one leverage capital was 8.1% and 7.6% at June 30, 2001 and December 31, 2000, respectively.

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PART I. Item 2. - FINANCIAL INFORMATION (cont'd.) 6/01-10QSB
Chesapeake Financial Shares, Inc.
Management's Discussion and Analysis of Financial
Condition or Plan of Operation (Unaudited)

B. Results of operations:

Earnings Summary:

Net income was \$1,264,855 for the six months ended June 30, 2001, compared with income of \$1,001,841 for the same period in 2000. On a fully diluted per share basis, the net income was \$1.00 for the first six months of 2001. Fully diluted earnings per share for the first six months of 2000 was \$0.79. Net interest income before provision increased \$557,717 or 14.4% and noninterest income increased \$317,041 or 13.6%. The Company experienced a net increase in noninterest expense (which includes other expense) of \$344,631 or 7.3%.

Net Interest Income:

Chesapeake Financial Shares' results of operation are significantly affected by its ability to manage effectively the interest rate sensitivity and maturity of its interest-earning assets and interest-bearing liabilities. At June 30, 2001, the Company's interest-earning assets exceeded its interest-bearing liabilities by approximately \$35.5 million, compared with a \$29.7 million excess one year ago.

Net interest margins are 4.53% at June 30, 2001 compared to 4.63% at June 30, 2000. Margins had narrowed during the later part of 1998 and the first half of 1999 due to falling rates and the resulting compression of spreads as deposit rates hit floors. Margins had generally improved through the first quarter of 2000, but since then compression of margins actually occurred again as short

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term rates continued upward, creating a flat yield curve through the end of 2000 and the competition with the brokerage firms for deposits intensified. In the current falling rate environment and steepening of the yield curve, management expects margins to improve slightly during the balance of the year due to higher priced deposits maturing in this lower rate environment. The Bank's sustained margin levels of 4.5% have been 30 basis points better than several Virginia community banks.

There has been reasonable growth in deposits in all trade areas of the bank and total deposits increased 4.2% since December 31, 2000 and 9.8% from one year ago. Total certificates of deposit have increased 11.2% from one year ago, but are down 1.3% from December 31, 2000. Large banks seem to be buying market share again with very aggressive "promotional specials" at the top of the market.

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PART I. Item 2. - FINANCIAL INFORMATION (cont'd.) 6/01-10QSB
Chesapeake Financial Shares, Inc.
Management's Discussion and Analysis of Financial
Condition or Plan of Operation (Unaudited)

Provision for Loan Losses:

The loan loss provision is a charge against earnings necessary to maintain the reserve for loan losses at a level consistent with management's evaluation of the credit quality and risk adverseness of the portfolio. Management makes a quarterly evaluation as to the adequacy of the current loan loss reserve. Management's detailed analysis as of June 30, 2001 supports the adequacy of the current loan loss level of \$2.4 million.

Chesapeake Bank's management maintains a reserve for loan loss that they feel represents a conservative estimate of potential losses in the Bank's loan portfolio. The methodology incorporates subjective factors into the evaluation of the adequacy of the ALLL such as:

- The effect of volume and trends in delinquencies and nonaccrual loans.
- The effect of trends in portfolio volume, maturity, and composition.
- An estimate of future loss on all significant loans and assessment of underwriting and lending policies and procedures including those for charge off, collection and recovery.
- Experience, ability and depth of lending management and staff.
- The effect of national and local economic conditions and downturns in specific industries.
- Concentrations of credit that might affect loss experience across one or more components of the portfolio.
- The results of any independent reviews of the portfolio.

The loan loss reserve was 1.5% and 1.3% of gross loans as of June 30, 2001 and December 31, 2000.

Noninterest Income:

Noninterest income is up 13.6% or \$317,041 from the same period last year. Chesapeake Bank's Cash Management product generated \$890,046 in gross revenue for the first six months ended June 30, 2001, compared to the same period last year of \$738,322. Managed assets in the Cash Management program were \$10,714,619 at June 30, 2001, and \$8,613,430 at June 30, 2000. Service Charges on deposit accounts were up 27.1%, or \$88,347, from one year ago due to increased account volume.

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The Other Income category was \$321,387, up 12.1%, or \$34,772 from one year ago.

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PART I. Item 2. - FINANCIAL INFORMATION (cont'd.) 6/01-10QSB
Chesapeake Financial Shares, Inc.
Management's Discussion and Analysis of Financial
Condition or Plan of Operation (Unaudited)

Noninterest Expenses:

Employee salary expense amounted to \$1,975,509 and \$1,720,065 for the six months ended June 30, 2001 and 2000, respectively. Benefits expense is up 9.0% or \$32,681 from June 30, 2000. These increases are directly related to new hires and increases for existing staff. Occupancy expenses were up \$83,675 or 10.8% from the same period one year ago due to general increases in prices of services used by the Bank.

Cash management expense was \$285,762 for the six months ended June 30, 2001, down 16.9% from the same period one year ago. This decrease is mainly due to the timing of expense receipts related to the business activity and reduced costs of services in a new contract arrangement.

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PART I. Item 2. - FINANCIAL INFORMATION (cont'd.) 6/01-10QSB
Chesapeake Financial Shares, Inc.
Management's Discussion and Analysis of Financial
Condition or Plan of Operation (Unaudited)

Assets and Loans:

At June 30, 2001, Chesapeake Financial Shares had total assets of \$ 234.4 million, up 4.6% from \$224.2 million at December 31, 2000 and up 10.1% from \$212.6 million of one year ago. Management has budgeted for a 7.0% growth in total assets for 2000.

Total loans (gross) at June 30, 2001 were \$164.0 million, representing an increase of 3.5% from December 31, 2000, when loans were \$158.5 million. Chesapeake Bank's loan quality is good as the following table shows. Management is confident that no serious delinquency trends are developing.

| | 6/30/01 | 12/31/00 |
|--------------------|-----------|-----------|
| | ----- | ----- |
| Nonaccrual loans | \$752,968 | \$562,813 |
| 90 days past due | 125,727 | 28,234 |
| Restructured loans | 0 | 0 |
| | ----- | ----- |
| Totals | \$878,695 | \$591,047 |

Management is also confident there will be no loss incurred as the Bank is well secured on these assets. There are no impaired loans outstanding at the end of either period.

Charged off loans through June 30, 2001, amounted to \$13,572 and charged off loans through June 30, 2000, were \$122,967. Recoveries through June 30, 2001 were \$1,474 as compared to \$1,860 as of June 30, 2000.

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Concentrations of credit in loans are compiled quarterly by management and reviewed with the Board of Director's Loan Review Committee. There have been no material changes in the concentrations of credit within the past three months that would warrant above average additions to the reserve. The Bank's only concentrations of credit greater than 70% of capital are individual consumer (226% of capital) and residential real estate (73% of total capital). Bank management feels that the current levels are consistent with the objectives of the Bank and do not represent unwarranted risk.

The Bank's Other Real Estate Owned (OREO) portfolio currently has one property with a total carrying value of \$20,000. Bank management is currently marketing this property. The Bank also has one repossessed asset valued at \$395.

Deposits:

Deposits were \$202.2 million at June 30, 2001 and \$194.0 million at December 31, 2000. Deposits were \$184.1 million at June 30, 2000. The Bank's mix of deposit dollars has changed from June 30, 2000 with net increases in all categories. It is management's opinion that this trend will continue in the current interest rate environment.

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PART II. Item 1. - OTHER INFORMATION 6/01-10QSB
Chesapeake Financial Shares, Inc.
Legal Proceedings

None to report

PART II. Item 2. - OTHER INFORMATION
Chesapeake Financial Shares, Inc.
Changes in Securities

None to report.

PART II. Item 3. - OTHER INFORMATION
Chesapeake Financial Shares, Inc.
Default Upon Senior Securities

None to report.

PART II. Item 4. - OTHER INFORMATION
Chesapeake Financial Shares, Inc.
Submission of Matters to a Vote of Security Holders

Chesapeake Financial Shares' annual meeting of shareholders was held on Friday, April 6, 2001 in Irvington, Virginia. We have previously forwarded to the Commission copies of the letter to shareholders, the notice of the meeting, the proxy statement, and the proxy. Over 90% of the shareholders were represented at the meeting in person or by proxy with over 89% voting in favor of the proposals submitted.

PART II. Item 5. - OTHER INFORMATION
Chesapeake Financial Shares, Inc.
Other Information

During the fourth quarter of 2000, the Company satisfactorily completed a

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Combined Safety and Soundness Examination performed by the Federal Reserve Bank of Richmond. As of December 2000, the Bank and the Company satisfactorily completed Transfer Agent Examination, also performed by the Federal Reserve Bank. As a result of these examinations management is not aware of any current recommendations of the regulatory authorities which, if they were implemented, would have a material effect on liquidity, capital resources or operations of the Bank or Holding Company.

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PART II. Item 6. - OTHER INFORMATION 6/01-10QSB
Chesapeake Financial Shares, Inc.
Exhibits and Reports on Form 8-K
(Unaudited)

| | | | |
|-----|------------|---|---|
| (a) | Exhibit 2 | Plan of acquisition, reorganization, arrangement, liquidation or succession | N/A |
| | Exhibit 4 | Instruments defining the rights of security holders, including indentures | N/A |
| | Exhibit 10 | Material contracts | N/A |
| | Exhibit 11 | Statement re: computation of earnings per share | See Part 1, Item Note 3 of this Form 10-QSB |
| | Exhibit 15 | Letter re: unaudited interim financial information | N/A |
| | Exhibit 18 | Letter re: change in accounting principles | N/A |
| | Exhibit 19 | Report furnished to security holders | N/A |
| | Exhibit 22 | Published report regarding matters submitted to vote of security holders | Previously Filed |
| | Exhibit 23 | Consents of experts and counsel | N/A |
| | Exhibit 24 | Power of attorney | N/A |
| | Exhibit 99 | Additional exhibits | N/A |

(b) No filings were made on Form 8-K for the period.

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SIGNATURES

Chesapeake Financial Shares, Inc.

SEC 10-QSB 6/01

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

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Chesapeake Financial Shares, Inc.

(Registrant)

08/08/01

(Date)

(Signature)

Douglas D. Monroe, Jr.
Chairman and Chief Executive Officer

08/08/01

(Date)

(Signature)

John H. Hunt, II
Secretary and Chief Financial Officer

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