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CHESAPEAKE FINANCIAL SHARES INC
Form 10KSB40
April 01, 2002

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-KSB

[X] ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the fiscal year ended December 31, 2001.

Commission file number 0-18543

CHESAPEAKE FINANCIAL SHARES, INC.

Virginia

(State or other jurisdiction of
incorporation or organization)

54-1210845

(I.R.S Employer
Identification No.)

19 N. Main St., Kilmarnock, VA

(Address of principal executive offices)

22482

(Zip Code)

Issuer's telephone number, including area code: (804)435-1181

Securities registered pursuant to Section 12(b) of the Exchange Act: None

Securities registered pursuant to Section 12(g) of the Exchange Act:

Common Stock (\$5.00 par value)

(Title of Class)

Check whether the issuer (1) has filed all reports required to be filed by
Section 13 or 15(d) of the Securities Exchange Act during the past 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 No

Check if there is no disclosure of delinquent filers in response to Item 405 of
Regulation S-B is not contained in this form and no disclosure will be
contained, to the best of registrant's knowledge, in definitive proxy or
information statements incorporated by reference in Part III of this Form 10-KSB
or any amendment to this Form 10-KSB. [X]

Issuer's Revenues for its most recent fiscal year: \$22,640,499.

As of March 1, 2002 the aggregate market value of Common Stock of Chesapeake
Financial Shares, Inc. held by nonaffiliates was approximately \$16,060,999 based
upon the average sales price per share known to management during January and
February 2002.

Indicate the number of shares outstanding of each of the issuer's classes of
common stock as of March 1, 2002.

| Class | Outstanding at March 1, 2002 |
|-------|------------------------------|
|-------|------------------------------|

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Common Stock, \$5.00 par value

1,261,158

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Annual Report to Shareholders for the year ended December 31, 2001 are incorporated into Part II, Items 5 through 7 of this Form 10-KSB.

Portions of the definitive proxy statement for the 2002 Annual Meeting of Stockholders are incorporated into Part III, Items 9 through 12 of this Form 10-KSB.

Transitional Small Business Disclosure Format Yes ___ No X

CHESAPEAKE FINANCIAL SHARES, INC.

FORM 10-KSB

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PART I

Item 1. Description of Business

The Company

Chesapeake Financial Shares, Inc. ("CFS" or "Chesapeake") is an independent, community owned financial services holding company based in Kilmarnock, Virginia. CFS was incorporated under the laws of the Commonwealth of Virginia in 1982 in connection with the reorganization of Chesapeake Bank (the "Bank", organized in 1900) into a one-bank holding company structure. CFS conducts substantially all of its business activities through its wholly-owned subsidiaries - the Bank and Chesapeake Investment Group, Inc. Chesapeake Investment Group, Inc. ("CIG") has as its subsidiaries Chesapeake Financial Group, Inc. ("CFG"), Chesapeake Insurance Agency, Inc., d/b/a Chesapeake Investment Services ("CIS"), and Chesapeake Trust Company ("CTC").

On December 31, 2001, Chesapeake and its subsidiaries had 121 full-time equivalent employees.

The Bank

The Bank is a full-service commercial bank incorporated under the laws of the Commonwealth of Virginia and traces its origins back to 1900. The current Bank was formed by the merger on April 27, 1968 of Chesapeake Banking Company, headquartered in Lively, Virginia, and Lancaster National Bank, headquartered in Irvington, Virginia. Lancaster National Bank was originally chartered on April 14, 1900, and Chesapeake Banking Company was organized on October 15, 1920. The Bank (formerly Chesapeake National Bank) converted from a national to a state chartered bank on June 27, 1995.

The Bank has grown to provide a full range of banking and related financial services, including checking, savings, certificates of deposit and other depository services; commercial, residential real estate and consumer loan services; and safekeeping services. Other products include Touch Tone Teller, 24 hour access services, internet banking with online billpayment, and check imaging. The Bank is a member of the Federal Reserve System and the Bank Insurance Fund of the Federal Deposit Insurance Corporation insures its deposits.

Total assets have increased 9.3%, 13.6% and 8.6% for each of the years ended December 31, 2001, 2000 and 1999, respectively, over prior years. At December 31, 2001, total loans, net of reserves, amounted to \$166.5 million, a 6.5% increase from \$156.3 million in total loans at December 31, 2000, which was a 19.7% increase from the previous year-end total of \$130.6 million at December 31, 1999. Growth in total deposits has followed a similar pattern with increases of 9.2%, 11.0% and 6.2% during 2001, 2000 and 1999, respectively, over prior years.

The Bank operates nine banking offices and eleven ATMs. The Bank's existing market area covers most of the area north of the Rappahannock River and south of the Potomac River known as the "Northern Neck", the area bounded on the south by

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the York River and on the north by the Rappahannock River, known as the "Middle Peninsula", and the Williamsburg area north of the James River.

The Bank's current market area is largely rural. The principal business activities in the area are related to small commercial enterprises and residential real estate activities, each of which have benefited from the area's popularity as a retirement and summer home location. The continued population growth of the York County - James City County/Williamsburg - Hampton triangle provides additional commercial and residential business activity, which has diversified and expanded traditional revenue sources.

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With the exception of the Bank's Rappahannock Westminster Canterbury Office (the "RWC Office"), the Gloucester Winn-Dixie Supermarket Office, and the Five Forks/Williamsburg Office, the Bank's Main Office and branch offices are held in fee, free of any encumbrances. The RWC Office is leased under an agreement that expires May 31, 2005. The Five Forks/Williamsburg Office lease expires December 31, 2005 with two five-year options. The Gloucester branch occupies facilities rented from Winn-Dixie Raleigh. The Bank relocated this office in January 2002, to a new banking facility on Bank owned property a short distance from the Winn-Dixie facility. The second term on the Gloucester lease expires in October of 2004 and this lease expense was recognized on the Bank's books at year-end.

The Bank's branch offices are located as follows:

| | | |
|--|---|---|
| Gloucester Winn-Dixie Office 6793 George Washington Memorial Highway Gloucester | Hayes Office George Washington Memorial Highway Hayes Shopping Center Hayes | Lively Office Route 3 & 201 Lively |
| Rappahannock Westminster Canterbury Office 10 Lancaster Drive Irvington | Kilmarnock Office 97 North Main Street Kilmarnock | Mathews Office Route 14 & 198 Mathews Courthouse Mathews |
| Irvington Office 98 King Carter Drive Irvington | Five Forks Office 4492 John Tyler Highway Williamsburg | Lafayette Street Financial Center 1229 Lafayette Street Williamsburg |

CFS owns 2.647 acres of commercial property (formerly the Colonial Store complex) on School Street in Kilmarnock. The building is approximately 27,000 square feet. Approximately half of the space is rented to two tenants, Advance Auto and deMedici's Fine Italian Restaurant. The remaining space is being used by the Bank's Administrative Support, Operations, and Loan Processing Center. Chesapeake's long term debt is secured by this property.

The Investment Companies

Chesapeake Financial Group, Inc. ("CFG") was incorporated August 31, 1998 and opened for business at the end of 1998. CFG offers superior portfolio management coupled with highly customized service to high net worth individuals and institutions. Chesapeake Investment Services offers annuity products (fixed and variable), mutual funds and discount brokerage products.

CFS chartered Chesapeake Investment Group, Inc. and Chesapeake Trust Company, Inc. during 2000. These two companies were part of a corporate

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restructuring that was completed during the first quarter of 2001. CIG is now a wholly owned subsidiary of Chesapeake Financial Shares, Inc. CTC has become a wholly owned subsidiary of CIG, as have CIS and CFG. The Bank has transferred a significant portion of the Trust Department's business to CTC. The Bank has retained its trust powers for certain unique accounts.

The motivation for this reorganization was to make more effective the presentation of Chesapeake's broad array of financial services, and to increase customer awareness of the financial expertise offered.

The Mortgage Company

Chesapeake Mortgage Company, Inc. (the "Mortgage Company"), which is a wholly owned subsidiary of CFS, is currently inactive.

See "Lending Activities" below for further information on the mortgage lending services offered by the Bank.

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Other Entities

CNB Properties, Inc., a wholly owned subsidiary of the Bank, was formed September 23, 1991, to provide a corporate vehicle to buy and hold properties (such as foreclosures) on a temporary basis.

Lending Activities

The Company provides a wide range of commercial, real estate, and consumer loan services through the Bank.

Commercial Lending. At December 31, 2001, the Bank's commercial loan portfolio amounted to \$84.4 million, or 49.9% of its total loan portfolio. Commercial lending activities to the Bank's commercial, industrial, and governmental customers include the making of asset-based and other secured loans, making unsecured loans, and offering demand and term loans. Management believes commercial loans offer the potential for better yields and repricing characteristics than most other types of loans. See Note 3 to the consolidated financial statements included in the Company's 2001 Annual Report to Shareholders (the "Annual Report") in Exhibit 13 to this report and incorporated by reference in this report for a breakdown of the major loan classifications. Of the \$84.4 million of commercial loans at December 31, 2001, 64.2% of such loans either matured or were subject to repricing within one year. (Also see Table 4 at page 18).

Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his employment and other income, commercial loans generally involve more risk. Commercial loans typically are made on the basis of the borrower's ability to make repayment from the cash flow of its business and are generally secured by real estate and the business assets, such as accounts receivable, equipment, and inventory. As a result, the availability of funds for the repayment of commercial loans may be substantially dependent on the success of the business itself. At December 31, 2001, some form of collateral secured 95.4% of the commercial loans and 0.75% of the Bank's commercial loan portfolio was 30 days or more delinquent. See Table 6 at page 20 showing the amount of commercial loans charged off during 2001 and 2000.

Real Estate Lending. The Bank's second largest loan category is its real estate loan portfolio (both mortgage and construction lending), which amounted

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to \$54.6 million at December 31, 2001, or 32.3% of the Bank's total loan portfolio. The Bank offers permanent fixed and adjustable rate first mortgage loans on one-to-four family residential properties. Most of the long-term fixed rate mortgages and the adjustable rate mortgages are underwritten and documented in accordance with the guidelines of the Federal Home Loan Mortgage Corporation and are sold in the secondary market within fifteen to sixty days after the loan closing date.

The Bank emphasizes the origination of adjustable rate mortgages in order to increase the proportion of the Company's total loan portfolio with more frequent repricing. At December 31, 2001, 32.7% of the mortgage portfolio was subject to repricing or maturing within twelve months.

The relative customer demand for adjustable-rate and fixed-rate residential mortgage loans has varied considerably, depending on such factors as the level of interest rates, expectations regarding future interest rates, and the supply of new housing units placed on the market in the Chesapeake's trade area. As part of its residential lending program, the Bank offers construction loans with 80% loan-to-value ratios to qualified builders and individuals. Construction loans generally have terms of up to twelve months, with interest rates generally as fixed commitments. Loan proceeds are disbursed in increments as construction progresses and as inspections warrant. In addition to builders' projects, the Bank finances the construction of individual, owner-occupied houses where qualified contractors are involved.

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Construction loans are structured either to be converted to permanent loans at the end of the construction phase or to be paid off upon receiving financing from another financial institution.

Construction loans afford the Bank the opportunity to charge higher loan origination fees, to increase the frequency of repricing of its loan portfolio and to earn yields higher than those obtainable on adjustable-rate loans secured by existing one - to - four family residential properties. These higher yields reflect the higher risks associated with construction lending, principally the difficulty in evaluating accurately the total funds required to complete a project and the post-completion value of the project. As a result, the Bank places a strong emphasis upon the borrower's ability to repay principal and interest.

Consumer Lending. As the competitive and regulatory environments have changed, Chesapeake has sought to expand its retail banking services to complement the range of traditional consumer services already offered. The Bank has maintained its emphasis on consumer lending notwithstanding the recent decrease in the consumer portfolio (an 11.3% decrease in 2001 from 2000, an 18.5% increase in 2000 over 1999 and a 25.5% increase in 1999 over 1998) due to the recent economic recession. The Bank currently originates a variety of consumer loans, including lines of credit secured by owner-occupied real estate, real estate equity loans, boat loans, loans secured by deposits, unsecured loans and automobile loans. The Bank's consumer loan portfolio was approximately \$28.2 million at December 31, 2001, or 16.7% of its total loan portfolio.

Consumer loans generally are considered to entail greater risk than residential mortgage loans secured by first liens on owner-occupied properties. The Bank's underwriting and screening processes have been designed to reduce this risk and have, to date, limited the Bank's consumer delinquency rate to levels below industry averages. At December 31, 2001, only 0.62% of the Bank's consumer loan portfolio was 30 days or more delinquent.

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CFS has adopted Financial Accounting Standards Board ("FASB") Statement No. 114, "Accounting by Creditors for Impairment of a Loan". This statement has been amended by FASB Statement No. 118, "Accounting by Creditors for Impairment of a Loan-Income Recognition and Disclosures". FASB Statement No. 114, as amended, requires that the impairment of loans that have been separately identified for evaluation is to be measured based on present value of expected future cash flows or, alternatively, the observable market price of the loans or the fair value of the collateral. However, for those loans that are collateral dependent (that is, if repayment of those loans is expected to be provided solely by the underlying collateral) and for which management has determined foreclosure is probable, the measure of impairment of those loans is to be based on the fair value of the collateral. FASB Statement No. 114, as amended also requires certain disclosures about investments in impaired loans and the allowance for credit losses and interest income recognized on loans.

CFS considers all consumer installment loans and residential mortgage loans to be homogeneous loans. These loans are not subject to impairment under FASB Statement No. 114. A loan is considered impaired when it is probable that CFS will be unable to collect all principal and interest amounts according to the contractual terms of the loan agreement. Factors involved in determining impairment include, but are not limited to, expected future cash flows, financial condition of the borrower, and the current economic conditions. A performing loan may be considered impaired, if the factors above indicate a need for impairment. A loan on nonaccrual status may not be considered impaired, if it is in the process of collection or there is an insignificant shortfall in payment. An insignificant delay of less than 30 days or a shortfall of 5% of the required principal and interest payment generally does not indicate an impairment situation, if in management's judgment the loan will be paid in full. Loans that meet the regulatory definitions of doubtful or loss generally qualify as impaired loans under FASB Statement No. 114.

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Charge-offs for impaired loans occur when the loan, or portion of the loan is determined to be uncollectible, as is the case for all loans. See Note 3 to the consolidated financial statements included in the Company's 2001 Annual Report to Shareholders (the "Annual Report") in Exhibit 13 to this report and incorporated by reference in this report for information about nonaccrual loans subject to FASB Statement No. 114.

Long-Term Debt

See Note 5 to the consolidated financial statements included in the Annual Report for information concerning term loan agreements of CFS.

Competition

CFS is subject to intense competition from various financial institutions and other companies or firms that offer financial services. In its market area, CFS is and will be competing with several national and regional banking institutions, including First Virginia Bank, Wachovia Bank, SunTrust Bank, Wachovia and Bank of America. CFS competes for deposits with other commercial banks, savings and loan associations, credit unions and with issuers of commercial paper and securities, such as money market and mutual funds. In making loans, Chesapeake competes with other commercial banks, savings and loan associations, consumer finance companies, credit unions, leasing companies and other lenders. Federal and state law changes in recent years have significantly increased competition among financial institutions, and current trends towards further deregulation may be expected to increase such competition even further.

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Many of the financial organizations in competition with Chesapeake have greater financial resources and are able to offer similar services at varying costs with greater loan capacities.

Supervision and Regulation

General. As a bank holding company and, effective December 7, 2000, a financial holding company under the Gramm-Leach-Bliley Act of 1999, the Company is subject to regulation under the Bank Holding Company Act of 1956, as amended (the "BHCA"), and the examination and reporting requirements of the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"). As a state-chartered commercial bank, the Bank is subject to regulation, supervision and examination by the State Corporation Commission of Virginia (the "SCC"). The Company also is registered under the bank holding company laws of Virginia and, accordingly, the Company is subject to regulation and supervision by the SCC.

The following description summarizes the significant state and Federal laws to which the Company and the Bank are subject. To the extent statutory or regulatory provisions or proposals are described, the description is qualified in its entirety by reference to the particular statutory or regulatory provisions or proposals.

The Gramm-Leach-Bliley Act of 1999. The Gramm-Leach-Bliley Act of 1999 (the "GLB Act" or the "Act"), signed into law on November 12, 1999, amended a number of Federal banking laws that affect the Company and the Bank, and the provisions of the Act that are believed to be of most significance to the Company are discussed below. In particular, the GLB Act permits a bank holding company to elect to become a financial holding company. In order to become and maintain its status as a financial holding company, the bank holding company and all of its affiliated depository institutions must be well-capitalized, well-managed, and have at least a satisfactory Community Reinvestment Act rating. The Company filed an election and on December 7, 2000, became a financial holding company.

Under the BHCA, a bank holding company, including a financial holding company, may not directly or indirectly acquire ownership or control of more than 5% of the voting shares or substantially all of the assets of any bank or merge or consolidate with another bank holding company without the prior

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approval of the Federal Reserve Board. The BHCA, as amended by the GLB Act, now generally limits the activities of a bank holding company that is a financial holding company to that of banking, managing or controlling banks; performing certain servicing activities for subsidiaries; and engaging in any activity, or acquiring and retaining the shares of any company engaged in any activity, that is either (1) financial in nature or incidental to such financial activity, as determined by the Federal Reserve Board in consultation with the Secretary of the Treasury; or (2) complementary to a financial activity and does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally, as determined by the Federal Reserve Board. Activities that are "financial in nature" include those activities that the Federal Reserve Board had determined, by order or regulation in effect prior to enactment of the GLB Act, to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

The GLB Act covers a broad range of issues, including a repeal of most of the restrictions on affiliations among depository institutions, securities firms and insurance companies. In particular, the GLB Act repeals sections 20 and 32 of the Glass-Steagall Act, thus permitting unrestricted affiliations

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between banks and securities firms. The Act also provides that, while the states continue to have the authority to regulate insurance activities, in most instances they are prohibited from preventing or significantly interfering with the ability of a bank, directly or through an affiliate, to engage in insurance sales, solicitations or cross-marketing activities. A financial holding company, therefore, may engage in or acquire companies that engage in a broad range of financial services, including securities activities such as underwriting, dealing, brokerage, investment and merchant banking; and insurance underwriting, sales and brokerage activities. Although the states generally must regulate bank insurance activities in a nondiscriminatory manner, the states may continue to adopt and enforce rules that specifically regulate bank insurance activities in certain areas identified in the Act.

The GLB Act, and certain new regulations issued by federal banking agencies, also provides new protections against the transfer and use by financial institutions of consumers' nonpublic personal information. A financial institution must provide to its customers, at the beginning of the customer relationship and annually thereafter, the institution's policies and procedures regarding the handling of customers' nonpublic personal financial information. The new privacy provisions generally prohibit a financial institution from providing a customer's personal financial information to unaffiliated third parties unless the institution discloses to the customer that the information may be so provided and the customer is given the opportunity to opt out of such disclosure.

Many of the GLB Act's provisions, including the customer privacy protection provisions, require the federal bank regulatory agencies and other regulatory bodies to adopt regulations to implement those respective provisions. Most of the required implementing regulations have been proposed and/or adopted by the bank regulatory agencies as of December 31, 2001.

Interstate Banking. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 authorizes the Federal Reserve Board to permit adequately capitalized and adequately managed bank holding companies to acquire all or substantially all of the assets of an out-of-state bank or bank holding company, subject to certain conditions, including nationwide and state concentration limits. Effective June 1, 1997, banks also are able to branch across state lines (unless state law would permit such interstate branching at an earlier date), provided certain conditions are met, including that applicable state law must expressly permit such interstate branching. Virginia has adopted legislation that permits branching across state lines effective July 1, 1995, provided there is reciprocity with the state in which the out-of-state bank is based.

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Capital Requirements. The Federal Reserve Board, the Office of the Comptroller of the Currency and the FDIC have issued substantially similar risk-based and leverage capital guidelines applicable to United States banking organizations. In addition, those regulatory agencies may from time to time require that banking organizations maintain capital above the minimum levels because of its financial condition or actual or anticipated growth. Under the risk-based capital requirements of these federal bank regulatory agencies, CFS and the Bank are required to maintain a minimum ratio of total capital to risk-weighted assets of at least 8%. At least half of the total capital is required to be "Tier 1 capital", which consists principally of common and certain qualifying preferred shareholders' equity, less certain intangibles and other adjustments. The remainder ("Tier 2 capital") consists of a limited amount of subordinated and other qualifying debt (including certain hybrid capital instruments) and a limited amount of the general loan loss allowance. The Tier 1

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and total capital to risk-weighted asset ratios of the Company as of December 31, 2001 were 10.2% and 11.5%, respectively, exceeding the minimums required.

In addition, each of the federal regulatory agencies has established a minimum leverage capital ratio (Tier 1 capital to average tangible assets). These guidelines provide for a minimum ratio of 4% for banks and bank holding companies that meet certain specified criteria, including that they have the highest regulatory examination rating and are not contemplating significant growth or expansion. All other institutions are expected to maintain a leverage ratio of at least 100 to 200 basis points above the minimum. The leverage ratio of CFS as of December 31, 2001, was 8.4%, which is above the minimum requirements. The guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets.

Limits on Dividends and Other Payments. Chesapeake Financial Shares, Inc. is a legal entity separate and distinct from its subsidiary institutions. Substantially all of the revenues of the Company result from dividends paid to it by the Bank. There are various legal limitations applicable to the payment of dividends to CFS as well as the payment of dividends by CFS to its respective shareholders.

Under federal law, the Bank may not, subject to certain limited exceptions, make loans or extensions of credit to, or investments in the securities of, CFS or take securities of CFS as collateral for loans to any borrower. The Bank is also subject to collateral security requirements from any loans or extensions of credit permitted by such exceptions.

The Bank is subject to various statutory restrictions on its ability to pay dividends to Chesapeake. Under the current supervisory practices of the Bank's regulatory agencies, prior approval from those agencies is required if cash dividends declared in any given year exceed net income for that year plus retained earnings of the two preceding years. Under these supervisory practices, at December 31, 2001, the Bank could have paid additional dividends to CFS of approximately \$3.5 million, without obtaining prior regulatory approval. The payment of dividends by the Bank or CFS may also be limited by other factors, such as requirements to maintain capital above regulatory guidelines. Bank regulatory agencies have authority to prohibit the Bank or CFS from engaging in an unsafe or unsound practice in conducting their business. The payment of dividends, depending upon the financial condition of the Bank, or CFS, could be deemed to constitute such an unsafe and unsound practice.

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Under the federal law, insured depository institutions such as the Bank are prohibited from making capital distributions, including the payment of dividends, if, after making such distribution, the institution would become "undercapitalized" (as such term is used in the statute). Based on the Bank's current financial condition, Chesapeake does not expect that this provision will have any impact on its ability to obtain dividends from the Bank.

Community Reinvestment Act. The Bank is also subject to the requirements of the Community Reinvestment Act (the "CRA"). The CRA imposes on financial institutions an affirmative and ongoing obligation to meet the credit needs of the local communities, including low and moderate income neighborhoods, consistent with the safe and sound operation of those institutions. Each financial institution's efforts in meeting community credit needs currently are evaluated as part of the examination process pursuant to twelve assessment

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factors. These factors also are considered in evaluating mergers, acquisitions and applications to open a branch or facility.

FDIC Insurance Assessment. As an institution with deposits insured by the Bank Insurance Fund, the Bank also is subject to insurance assessments imposed by the FDIC. The FDIC has implemented a risk-based deposit insurance assessment system under which the assessment rate for an insured institutions may vary according to regulatory capital levels of the institution and other factors (including supervisory evaluations). Under the final risk-based assessment system there are nine assessment risk classifications (i.e., combinations of capital groups and supervisory subgroups) to which different assessment rates are applied. Assessment rates for deposit insurance currently range from zero basis points to 27 basis points. The capital and supervisory subgroup to which an institution is assigned by the FDIC is confidential and may not be disclosed. A bank's rate of deposit insurance assessments will depend upon the category and subcategory to which the bank is assigned by the FDIC. Any increase in insurance assessments could have an adverse effect on the earnings of insured institutions, including the Bank.

Under the Federal Deposit Insurance Act, insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order, or condition imposed by the FDIC. Management does not know of any practice, condition, or violation that might lead to termination of deposit insurance.

Other Safety and Soundness Regulations. There are a number of obligations and restrictions imposed on bank holding companies and their depository institution subsidiaries by Federal law and regulatory policy that are designed to reduce potential loss exposure to the depositors of such depository institutions and to the FDIC insurance funds in the event the depository institution becomes in danger of default or is in default. For example, under a policy of the Federal Reserve Board with respect to bank holding company operations, a bank holding company is required to serve as a source of financial strength to its subsidiary depository institutions and to commit resources to support such institutions in circumstances where it might not do so otherwise. In addition, the "cross-guarantee" provisions of Federal law require insured depository institutions under common control to reimburse the FDIC for any loss suffered or reasonably anticipated by the BIF as a result of the default of a commonly controlled insured depository institution or for any assistance provided by the FDIC to a commonly controlled insured depository institution in danger of default. The FDIC may decline to enforce the cross-guarantee provision if it determines that a waiver is in the best interests of the BIF. The FDIC's claim for reimbursement is superior to claims of shareholders of the insured depository institution or its holding company but is subordinate to claims of depositors, secured creditors and holders of subordinated debt (other than affiliates) of the commonly controlled insured depository institution.

The Federal banking agencies also have broad powers under current Federal law to take prompt corrective action to resolve problems of insured depository institutions. The FDIA requires that the federal banking agencies establish five capital levels for insured depository institutions - "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized." It also requires or permits such agencies to take certain supervisory actions should an insured institution's capital level fall. For example, an "adequately capitalized"

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institution is restricted from accepting brokered deposits. An "undercapitalized" or "significantly undercapitalized" institution must develop a capital restoration plan and is subject to a number of mandatory and discretionary supervisory actions. These powers and authorities are in addition to the traditional powers of the Federal banking agencies to deal with undercapitalized institutions.

Federal regulatory authorities also have broad enforcement powers over the Company and the Bank, including the power to impose fines and other civil and criminal penalties, and to appoint a receiver in order to conserve the assets of any such institution for the benefit of depositors and other creditors.

Other

During the fourth quarter of 2000, the Company satisfactorily completed a Combined Safety and Soundness Examination performed by the Federal Reserve Bank of Richmond. As of February 2001, the Bank and the Company satisfactorily completed Transfer Agent Examination, also performed by the Federal Reserve Bank. During the first quarter of 2002, the Company had substantially completed a safety and soundness examination by the Virginia Bureau of Financial Institutions that was the first regulatory review since the corporate restructuring. 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 CFS.

Forward-Looking Statements

This report contains certain forward-looking statements with respect to the financial condition, results of operations, plans, objectives and business of the Company and the Bank. These forward-looking statements involve certain risks and uncertainties. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, among others, the following possibilities: (a) competitive pressure in the financial services industry increases significantly; (b) changes in the interest rate environment reduce margins; (c) general economic conditions, either nationally or regionally, are less favorable than expected, resulting in, among other things, a deterioration in credit quality; (d) changes occur in the financial services regulatory environment; and (e) changes occur in the securities markets.

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Item 1. Statistical Information

The following statistical information is furnished pursuant to the requirements of Guide 3 (Statistical Disclosure by Bank Holding Companies) promulgated under the Securities Act of 1933.

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TABLE 1
AVERAGE BALANCES, INCOME AND EXPENSES, YIELDS AND RATES

The following table depicts interest income on earnings assets and related average yields as well as interest expense on interest-bearing liabilities and related average rates paid for the periods indicated.

| | Year Ended December 31, | | | | | | |
|---|-------------------------|--------------------|--------|-----------|--------------------|--------|-----------|
| | 2001 | | | 2000 | | | |
| | Average | Annual | Yield/ | Average | Annual | Yield/ | Average |
| | Balance | Income/ Expense | Rate | Balance | Income/ Expense | Rate | Balance |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| | (Dollars in thousands) | | | | | | |
| Assets: | | | | | | | |
| Securities: | | | | | | | |
| Taxable | \$ 21,708 | \$ 1,333 | 6.14% | \$ 24,909 | \$ 1,671 | 6.71% | \$ 29,351 |
| Tax-exempt (1) | 16,091 | 899 | 8.49% | 15,224 | 838 | 8.34% | 13,291 |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| Total securities | 37,799 | 2,232 | 7.14% | 40,133 | 2,509 | 7.33% | 42,642 |
| Loans (net of unearned income): | | | | | | | |
| Taxable (2) | 162,527 | 14,442 | 8.89% | 143,960 | 13,073 | 9.08% | 119,470 |
| Tax-exempt (1) | 889 | 60 | 10.26% | 1,145 | 79 | 10.48% | 1,846 |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| Total loans | 163,416 | 14,502 | 8.89% | 145,105 | 13,152 | 9.09% | 121,316 |
| Federal funds sold and repurchase agreements | 3,690 | 116 | 3.17% | 75 | 6 | 8.00% | 975 |
| Interest-bearing deposits in other banks | 0 | 0 | 0% | 0 | 0 | 0% | 284 |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- |

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| | | | | | | | |
|---------------------------------|-----------|--------|-------|-----------|--------|-------|-----------|
| Total earning assets | 204,905 | 16,850 | 8.47% | 185,313 | 15,667 | 8.71% | 165,217 |
| Less: allowance for loan losses | (2,403) | | | (2,324) | | | (2,137) |
| Total nonearning assets | 30,787 | | | 28,066 | | | 24,349 |
| | ----- | | | ----- | | | ----- |
| Total assets | \$233,289 | | | \$211,055 | | | \$187,429 |
| | ----- | | | ----- | | | ----- |

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TABLE 1 (cont.)
AVERAGE BALANCES, INCOME AND EXPENSES, YIELDS AND RATES

| | Year Ended December 31, | | | | | |
|--|-------------------------|---------|--------|-----------|---------|-------|
| | 2001 | | | 2000 | | |
| | Average | Annual | Yield/ | Average | Annual | Yield |
| | Balance | Income/ | Rate | Balance | Income/ | Rate |
| | ----- | Expense | ----- | ----- | Expense | ----- |
| | (Dollars in thousands) | | | | | |
| Liabilities and Shareholder's Equity: | | | | | | |
| Interest-bearing deposits: | | | | | | |
| Checking | \$ 57,893 | \$1,385 | 2.39% | \$ 52,221 | \$1,798 | 3.44% |
| Regular savings | 10,393 | 203 | 1.95% | 10,172 | 275 | 2.70% |
| Money market savings | 4,289 | 105 | 2.45% | 3,860 | 113 | 2.93% |
| Certificates of deposit: | | | | | | |
| \$100,000 and over | 27,649 | 1,477 | 5.34% | 21,543 | 1,353 | 6.28% |
| Under \$100,000 | 72,381 | 3,963 | 5.48% | 68,284 | 3,894 | 5.70% |
| | ----- | ----- | | ----- | ----- | |
| Total interest-bearing deposits | 172,605 | 7,133 | 4.13% | 156,080 | 7,433 | 4.76% |
| Federal funds purchased | 7,219 | 347 | 4.81% | 5,745 | 396 | 6.89% |
| Other borrowings | 808 | 44 | 5.45% | 835 | 42 | 5.03% |
| | ----- | ----- | | ----- | ----- | |
| Total interest-bearing liabilities | 180,632 | 7,524 | 4.17% | 162,660 | 7,871 | 4.84% |
| Noninterest bearing liabilities: | | | | | | |
| Demand deposits | 30,044 | | | 28,734 | | |
| Other liabilities | 3,514 | | | 2,956 | | |
| | ----- | | | ----- | | |
| Total liabilities | 214,190 | | | 194,350 | | |
| Shareholders' equity | 19,099 | | | 16,705 | | |
| Total liabilities and shareholders' equity | \$233,289 | | | \$211,055 | | |
| | ----- | | | ----- | | |
| Net interest income/yield | | \$9,326 | 4.80% | | \$7,796 | 4.46% |
| Interest rate spread | | | 4.30% | | | 3.87% |

- 1) Yields are reported on a taxable equivalent basis assuming a federal tax rate of 34%.
- 2) Includes non-accrual loans.

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TABLE 2
VOLUME AND RATE ANALYSIS

The following table analyzes changes in net interest income attributable to changes in the volume of interest-bearing assets and liabilities compared to changes in interest rates. Nonaccruing loans are included in average loans outstanding.

| | 2001 vs.2000 Increase (Decrease) Due to Changes in:(1) (2) | | | Year Ended December 31, 2000 vs. 1999 Increase (Decrease) Due to Changes in:(1) (2) | | |
|--|--|------------|----------|--|----------|----------|
| | Volume | Rate | Total | Volume | Rate | Total |
| | ----- | ---- | ----- | ----- | ---- | ----- |
| | (In thousands) | | | | | |
| Earning Assets: | | | | | | |
| Securities: | | | | | | |
| Taxable | \$ (215) | \$ (123) | \$ (338) | \$ (255) | \$ 238 | \$ (17) |
| Tax-exempt | 48 | 13 | 61 | 99 | 55 | 15 |
| Loans: | | | | | | |
| Taxable | 1,686 | (317) | 1,369 | 2,226 | (12) | 2,214 |
| Tax-exempt | (17) | (2) | (19) | (52) | (7) | (59) |
| Federal funds sold | 288 | (178) | 110 | (37) | 3 | (34) |
| Interest-bearing deposits in other banks | 0 | 0 | 0 | (14) | 0 | (14) |
| Total earning assets | \$ 1,790 | \$ (607) | \$ 1,183 | \$ 1,967 | \$ 277 | \$ 2,244 |
| Interest-Bearing Liabilities: | | | | | | |
| Interest checking | \$ 195 | \$ (608) | \$ (413) | \$ 71 | \$ 73 | \$ 14 |
| Regular savings | 6 | (78) | (72) | 13 | (20) | (7) |
| Money market savings | 12 | (20) | (8) | (17) | 1 | (15) |
| Time deposits: | | | | | | |
| CDS \$100,000 or more | 383 | (259) | 124 | 342 | 330 | 672 |
| CDS Other | 233 | (164) | 69 | 262 | 400 | 664 |
| Total interest-bearing deposits | 829 | (1,129) | (300) | 671 | 784 | 1,455 |
| Federal funds purchased | 101 | (150) | (49) | 163 | 84 | 247 |
| Other borrowing | 1 | 1 | 2 | (1) | (4) | (3) |
| Total interest-bearing liabilities | \$ 931 | \$ (1,278) | \$ (347) | \$ 833 | \$ 864 | \$ 1,697 |
| Change in net interest income: | \$ 859 | \$ 671 | \$ 1,530 | \$ 1,134 | \$ (587) | \$ 547 |

(1) The change in interest due to both rate and volume has been allocated to change due to volume and change due to rate in proportion to the relationship of the absolute dollar amounts of the change in each.

(2) The combined effect of changes in both volume and rate that cannot be separately identified has been allocated proportionately to the change due to volume and change due to rate.

TABLE 3
SECURITIES HELD FOR RESALE AND INVESTMENT
MATURITY DISTRIBUTION AND AVERAGE YIELD

| | 2001 | December 31, 2000 | 1999 |
|---------------------------------------|----------|----------------------|----------|
| | ---- | ---- | ---- |
| Book Value: | | (In thousands) | |
| U.S. Government securities..... | \$17,701 | \$21,054 | \$24,199 |
| State and political subdivisions..... | 15,152 | 15,110 | 13,571 |
| Other securities..... | 2,488 | 2,552 | 2,555 |
| | ----- | ----- | ----- |
| Total securities..... | \$35,341 | \$38,716 | \$40,325 |

| | Maturities of Securities Held at December 31, 2001 | | | | |
|-----------------------------------|--|----------|----------|-----------|----------|
| | One | One | Five | Over Ten | |
| | Year | to Five | to Ten | Years and | |
| | or Less | Years | Years | Equity | Total |
| | ----- | ----- | ----- | ----- | ----- |
| | (Dollars in thousands) | | | | |
| State and Political Subdivisions: | | | | | |
| Book value | 852 | 708 | 2,517 | 11,075 | 15,152 |
| Market value | 913 | 682 | 2,611 | 11,450 | 15,656 |
| Weighted average yield(1) | 10.50% | 8.35% | 8.18% | 8.28% | 8.40% |
| Corporate Debt Securities: | | | | | |
| Book value | -- | 1,539 | 0 | -- | 1,539 |
| Market value | -- | 1,551 | 0 | -- | 1,551 |
| Weighted average yield(1) | 0% | 6.71% | 0% | 0% | 6.71% |
| Mortgage Backed Securities: | | | | | |
| Book value | 3,717 | 12,737 | 1,247 | -- | 17,701 |
| Market value | 3,772 | 12,926 | 1,267 | -- | 17,965 |
| Weighted average yield(1) | 7.81% | 6.68% | 7.99% | 0% | 7.01% |
| Other Securities: | | | | | |
| Book Value | -- | -- | -- | 949 | 949 |
| Market Value | -- | -- | -- | 949 | 949 |
| Weighted Average Yield(1) | 0% | 0% | --% | 5.07% | 5.07% |
| Total Securities: | | | | | |
| Book value | \$ 4,569 | \$14,984 | \$ 3,764 | \$12,024 | \$35,341 |
| Market value | 4,685 | 15,759 | 3,878 | 12,399 | 36,121 |
| Weighted average yield(1) | 8.30% | 6.74% | 7.87% | 8.10% | 7.55% |

(1) Yields on tax-exempt securities have been computed on a tax-equivalent basis.

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TABLE 4
LOAN PORTFOLIO AND MATURITY SCHEDULE OF SELECTED LOANS
AS OF DECEMBER 31, 2001

| | December 31, | | | | |
|---------------------------------|----------------|-----------|-----------|-----------|-----------|
| | 2001 | 2000 | 1999 | 1998 | 1997 |
| | ---- | ---- | ---- | ---- | ---- |
| | (In thousands) | | | | |
| Commercial | \$ 84,398 | \$ 76,315 | \$ 62,100 | \$ 49,058 | \$ 43,370 |
| Real estate mortgage | 46,605 | 41,674 | 36,955 | 33,003 | 38,946 |
| Real estate construction | 7,947 | 5,464 | 2,794 | 5,468 | 2,900 |
| Consumer | 28,192 | 31,792 | 26,832 | 21,379 | 16,268 |
| Participations with other banks | 1,608 | 2,378 | 2,691 | 1,610 | 1,946 |
| Other | 265 | 833 | 1,521 | 928 | 409 |
| | ----- | ----- | ----- | ----- | ----- |
| Total | \$169,015 | \$158,456 | \$132,893 | \$111,446 | \$103,839 |

For the accompanying notes addressing the loan portfolio, see "Note 3. Loans" on page 14 of the Annual Report to Shareholders which is incorporated by reference herein (attached as Exhibit 13 to this Form 10-KSB).

The maturity distribution and rate sensitivity of certain categories of loans as of December 31, 2001 is presented below. Management considers the liquidity of CFS to be adequate. Sufficient assets are maintained on a short-term basis to meet the liquidity demands anticipated by management. In addition, secondary sources are available through the use of borrowed funds. See Table 10 at page 22.

| | 1 Year or Less | | 1-5 Years | | Over 5 Years | |
|--------------------------|------------------------|---------------|------------|---------------|--------------|---------------|
| | Fixed Rate | Variable Rate | Fixed Rate | Variable Rate | Fixed Rate | Variable Rate |
| | ---- | ---- | ---- | ---- | ---- | ---- |
| | (Dollars in thousands) | | | | | |
| Commercial and other | \$ 5,725 | \$48,651 | \$ 6,802 | \$19,221 | \$ 3,442 | \$ 823 |
| Real estate-construction | 0 | 574 | 0 | 7,373 | 0 | 0 |
| Real estate mortgage | 4,475 | 12,787 | 6,829 | 14,584 | 7,663 | 267 |
| Consumer installment | 6,177 | 4,093 | 6,481 | 570 | 10,837 | 34 |
| | ----- | ----- | ----- | ----- | ----- | ----- |
| Total | \$16,377 | \$66,105 | \$20,112 | \$41,748 | \$21,942 | \$ 1,124 |
| | ----- | ----- | ----- | ----- | ----- | ----- |

TABLE 5
RISK ELEMENTS

Risk elements associated with the loan portfolio are presented below. CFS places a loan on nonaccrual status when management believes, after considering economic and business conditions and collection efforts, that

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the borrower's financial condition is such that collection of principal and interest is doubtful. Chesapeake's policy is to place loans on nonaccrual status if principal or interest is past due for 90 days or more unless the debt is both well secured and in the process of being collected.

| | December 31, ----- | | | | |
|--|------------------------|--------|----------|--------|---------|
| | (Dollars in thousands) | | | | |
| | 2001 | 2000 | 1999 | 1998 | 1997 |
| | ----- | ----- | ----- | ----- | ----- |
| Nonaccrual loans (1) | \$ 822 | \$ 563 | \$ 155 | \$ 202 | \$ 581 |
| Restructured loans | 0 | 0 | 0 | 0 | 0 |
| Foreclosed properties | 45 | 175 | 185 | 185 | 245 |
| | ----- | ----- | ----- | ----- | ----- |
| Total nonperforming Assets | \$ 867 | \$ 738 | \$ 340 | \$ 387 | \$ 826 |
| | ----- | ----- | ----- | ----- | ----- |
| Loans past due 90+ days and accruing interest | \$ 22 | \$ 28 | \$ 4 | \$ 4 | \$ 14 |
| Allowance for loan losses to period end loans | 1.5% | 1.3% | 1.7% | 1.8% | 1.7% |
| Allowance for loan losses to nonaccrual loans | 309.0% | 377.6% | 1,449.1% | 999.7% | 299.5% |
| Nonperforming assets to period-end loans and foreclosed properties | 0.51% | 0.47% | 0.26% | 0.35% | 0.80% |
| Net charge-offs (recoveries) to average loans | 0.17% | 0.37% | (0.02%) | 0.32% | (0.01%) |

(1) During 2001, approximately \$91,000 in additional interest income would have been recorded if CFS's nonaccrual loans had been current and in accordance with original terms.

(2) There were no troubled debt restructurings in 2001, 2000, 1999, 1998, or 1997. The Bank expects to charge off \$637,926 in problem loans (fully reserved at December 31, 2001). These loans present potential risk of non-payment and are not included in the numbers above. The Bank expects to collect all other payments due. See the discussion on page 31 of the 2001 Annual Report to Shareholders and Note 3 to the Financial Statements contained therein for additional information on the risk elements associated with the loan portfolio.

(3) As of December 31, 2001, performing loans totaling approximately \$9.6 million were identified as potential problem loans through internal loan review systems and procedures. The Bank has specifically reserved for potential losses in these loans as of year-end.

Loan Concentrations: The Bank has no concentration of credit that exceeds 10% of gross loans, except individual consumer.

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TABLE 6
SUMMARY OF ALLOWANCE FOR LOAN LOSS

The following table shows Chesapeake's loan loss and recovery experience for the past five years.

Chesapeake tries to maintain an allowance for loan loss that represents an estimate of all losses estimated in the Bank's loan portfolio. To achieve this goal, the loan loss provision must be sufficient to cover charged-off loans plus growth in the loan portfolio. The loan loss provision is a charge against earnings necessary to maintain the allowance for loan losses at management's targeted level. In considering the provision for loan loss, an evaluation of the loan portfolio is conducted. Loans in non-accrual status and loans past due over ninety days are considered in this evaluation as well as other loans CFS feels may be a potential loss. The status of non-accrual and past due loans varies from quarter to quarter based on seasonality and cash flow of customers.

| | Year ended December 31, | | | | |
|---|-------------------------|----------|----------|----------|----------|
| | 2001 | 2000 | 1999 | 1998 | 1997 |
| | (Dollars in thousands) | | | | |
| Balance, beginning of period | \$ 2,125 | \$ 2,254 | \$ 2,024 | \$ 1,740 | \$ 1.653 |
| Loans charged off: | | | | | |
| Commercial | (278) | (532) | (8) | (330) | (29) |
| Real estate construction | 0 | 0 | 0 | 0 | 0 |
| Real estate mortgage | (20) | (57) | 0 | 0 | (3) |
| Consumer | (32) | (23) | (19) | (25) | (10) |
| Total loans charged off | (330) | (612) | (27) | (355) | (42) |
| Recoveries of loans previously charged off: | | | | | |
| Commercial | 45 | 2 | 27 | 0 | 35 |
| Real estate - construction | 0 | 0 | 0 | 0 | 0 |
| Real estate - mortgage | 2 | 1 | 0 | 7 | 0 |
| Consumer | 2 | 75 | 19 | 12 | 19 |
| Total recoveries | 49 | 78 | 46 | 19 | 54 |
| Net loans (charged off) recovered | (281) | (534) | 19 | (336) | 12 |
| Provision for loan losses | 697 | 405 | 211 | 620 | 75 |
| Balance, end of period | \$ 2,541 | \$ 2,125 | \$ 2,254 | \$ 2,024 | \$ 1,740 |

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TABLE 7
ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES

The following table provides a breakdown of the allowance for loan losses by major categories of Chesapeake's loan portfolio.

| | 2001 | | 2000 | | 1999 | | Amount |
|--------------------------|-----------------------------------|------------|---------|------------|---------|------------|---------|
| | Amount | % of Loans | Amount | % of Loans | Amount | % of Loans | |
| | Percent of loans in each category | | | | | | |
| | (Dollars in thousands) | | | | | | |
| Commercial | \$1,536 | 49.9% | \$1,236 | 48.2% | \$1,559 | 46.7% | \$1,236 |
| Real estate construction | 0 | 4.6 | 0 | 3.4 | 0 | 2.1 | 0 |
| Real estate mortgage | 508 | 27.7 | 482 | 26.3 | 408 | 27.8 | 466 |
| Consumer | 422 | 16.6 | 364 | 20.1 | 264 | 20.2 | 293 |
| Other | 75 | 0.2 | 43 | 0.5 | 23 | 1.1 | 23 |
| Participations | 0 | 1.0 | 0 | 1.5 | 0 | 2.1 | 0 |
| Total | \$2,541 | 100.0% | \$2,125 | 100.0% | \$2,254 | 100.0% | \$2,023 |

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TABLE 8
DEPOSITS

The average balance and rates for certain categories of deposits for the last three years are shown in the following table:

| | 2001 | | 2000 | | Average Balance |
|---|-------------------------|--------------|-----------------|--------------|-----------------|
| | Average Balance | Average Rate | Average Balance | Average Rate | |
| | Year ended December 31, | | | | |
| | (Dollars in thousands) | | | | |
| Non-interest bearing demand deposits | \$ 30,044 | | \$ 28,734 | | \$ 23,990 |
| Interest bearing deposits: | | | | | |
| Interest checking | 57,893 | 2.39% | 52,221 | 3.44% | 50,060 |
| Regular savings | 10,393 | 1.95 | 10,172 | 2.70 | 10,950 |
| Money market savings | 4,289 | 2.45 | 3,860 | 2.93 | 4,460 |
| Time deposits: | | | | | |
| Certificates of deposit \$100,000 or more | 27,649 | 5.34 | 21,543 | 6.28 | 14,320 |
| Other certificates | | | | | |

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| | | | | | |
|---------------------------------|-----------|-------|-----------|-------|--------|
| of deposit | 72,381 | 5.48 | 68,284 | 5.70 | 63,15 |
| | ----- | | ----- | | ----- |
| Total interest bearing deposits | 172,605 | 4.13 | 156,080 | 4.76 | 142,96 |
| | ----- | | ----- | | ----- |
| Total deposits | \$202,649 | 3.52% | \$184,814 | 4.02% | 166,96 |
| | ----- | | ----- | | ----- |

Maturities of time certificates of deposits of \$100,000 or more outstanding at December 31, 2001 were:

| | |
|------------------|------------------------|
| | 2001 |
| | ---- |
| | (Dollars in thousands) |
| 3 months or less | \$11,810 |
| 3 - 6 months | 4,165 |
| 6 - 12 months | 3,226 |
| Over 12 months | 7,465 |
| | ----- |
| Total | \$26,666 |

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TABLE 9
RETURN ON EQUITY AND ASSETS

The ratio of net income to average total assets and average shareholders' equity and certain other ratios for the periods indicated are as follows:

| | | | |
|----------------------------------|-------------------------|--------|--------|
| | Year ended December 31, | | |
| | ----- | | |
| | 2001 | 2000 | 1999 |
| | ---- | ---- | ---- |
| Return on average assets | 1.13% | 1.06% | 1.10% |
| Return on average equity | 13.82% | 13.34% | 13.44% |
| Dividend payout ratio | 21.22% | 22.10% | 19.73% |
| Average equity to average assets | 8.19% | 7.91% | 8.18% |

TABLE 10
SHORT TERM BORROWING

The Bank periodically borrows funds through federal funds from its correspondent banks, through securities sold under agreements to repurchase, through the Federal Home Loan Bank of Atlanta, and through the discount window at the Federal Reserve Bank of Richmond. The borrowings generally mature daily for cash flow requirements, however, short term borrowing may extend to 18 months. The borrowed amounts and their corresponding rates during 2001, 2000 and 1999 are presented below:

Year ended December 31,

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| | 2001 | 2000 | 1999 |
|--------------------------------------|------------------------|----------|---------|
| | (Dollars in thousands) | | |
| Average daily amount outstanding | \$ 7,219 | \$ 5,745 | \$2,737 |
| Average interest rate | 4.81% | 6.89% | 5.44% |
| Maximum outstanding at any month end | \$11,400 | \$11,100 | \$9,000 |
| Balance at end of period | \$10,000 | \$ 9,500 | \$4,800 |

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TABLE 11
INTEREST SENSITIVITY ANALYSIS

| | December 31, 2001 | | | | |
|--|------------------------|----------------|-----------------|-----------------|-----------|
| | Within 90 Days | 90-365 Days | 1 to 5 Years | Over 5 Years | Total |
| | (Dollars in thousands) | | | | |
| Earnings Assets: | | | | | |
| Loans (2) | \$ 49,150 | \$ 35,731 | \$ 61,067 | \$ 23,068 | \$169,016 |
| Securities & Time Deposits with other banks | 2,228 | 5,305 | 11,513 | 17,074 | 36,120 |
| Federal funds sold and other short- term investments (3) | 19,521 | -- | -- | -- | 19,521 |
| Total interest earning assets | \$ 70,899 | \$ 41,036 | \$ 72,580 | \$ 40,142 | \$224,657 |
| Interest-Bearing Liabilities: | | | | | |
| Interest checking, savings and money market savings (4) | \$ 4,990 | \$ 10,712 | \$ 67,644 | \$ -- | \$ 83,346 |
| Certificates of deposit: | | | | | |
| \$100,000 and over | 11,810 | 7,391 | 7,465 | -- | 26,666 |
| Under \$100,000 | 26,259 | 21,214 | 20,741 | -- | 68,214 |
| Federal funds purchased and securities sold under agreements to repurchase | 0 | 7,500 | 2,500 | -- | 10,000 |
| Other borrowing | 6 | 21 | 121 | 644 | 792 |
| Total interest- | | | | | |

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| | | | | | |
|--|-----------|------------|-------------|-----------|-----------|
| bearing liabilities | \$ 43,065 | \$ 46,838 | \$ 98,471 | \$ 644 | \$189,018 |
| | ----- | ----- | ----- | ----- | ----- |
| Period gap | \$ 27,834 | \$ (5,802) | \$ (25,891) | \$ 39,498 | \$ 35,639 |
| Cumulative gap | | \$ 22,032 | \$ (3,859) | \$ 35,639 | |
| Ratio of cumulative gap to total earning assets(4) | 12.39% | 9.81% | -1.72% | 15.86% | |

(1) The repricing dates may differ from maturity dates for certain assets due to prepayment assumptions.

(2) Includes nonaccrual loans.

(3) Includes cash management accounts

(4) The Bank's Asset Liability Management Committee has found that interest bearing checking accounts and regular saving accounts are generally not sensitive to changes in interest rates. However, current interest rate levels have warranted placing approximately 6.0% of these balances in the 90 day category.

(5) The Bank's Asset Liability Management Committee monitors interest rate risk using gap analysis and rate shock - market value - duration analysis using regulatory guidelines. The relative risk to earnings based on the gaps in the table above is considered reasonable by management and is within limits established by the Board of Directors.

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TABLE 12
ANALYSIS OF CAPITAL *

| | December 31, | |
|----------------------------|------------------------|-----------|
| | 2001 | 2000 |
| | ---- | ---- |
| | (Dollars in thousands) | |
| Tier 1 Capital: | | |
| Common stock | \$ 6,277 | \$ 6,149 |
| Additional paid in capital | 230 | 154 |
| Retained earnings | 13,553 | 11,473 |
| Less: Goodwill | 0 | 0 |
| | ----- | ----- |
| Total Tier 1 capital | \$ 20,060 | \$ 17,776 |
| Tier 2 Capital: | | |
| Allowance for loan losses | 2,457 | 2,272 |
| Allowable long-term debt | 0 | 0 |
| | ----- | ----- |
| Total Tier 2 Capital | 2,457 | 2,272 |
| Total risk-based capital | \$ 22,517 | \$ 20,048 |
| | ----- | ----- |
| Risk weighted assets | \$196,040 | \$180,199 |
| Capital Ratios: | | |

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| | | |
|--|-------|------|
| Tier 1 risk-based capital ratio | 10.2% | 9.8% |
| Total risk-based capital ratio | 11.5 | 11.0 |
| Tier 1 capital to average adjusted total assets | 8.4 | 8.1 |

* See the captioned "Note 17 Minimum Regulatory Capital Requirements" which is included in Exhibit #13 at page 25, The Annual Report to Shareholders was filed with the Commission on March 6, 2002.

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PART I cont'd.

ITEM 2. Description of Property

CFS owns one property at December 31, 2001 which was purchased on January 2, 1998 that is described in PART I, Item 1. The Bank, however, owns and leases properties as also described in PART 1, Item 1 of this report.

ITEM 3. Legal Proceedings

The Bank is currently not involved in any material legal proceeding other than ordinary litigation incidental to its business.

ITEM 4. Submission of Matters to a Vote of Security Holders

There were no matters submitted to a vote of security holders during the quarter ended December 31, 2001.

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PART II

ITEM 5. Market for Common Equity and Related Shareholder Matters

This information is included in the 2001 Annual Report to Shareholders at page 32 in the section captioned, "Dividend and Market Information".

ITEM 6. Management's Discussion and Analysis or Plan of Operation

This information is included in the 2001 Annual Report to Shareholders at pages 30-34.

ITEM 7. Financial Statements

This information is included in the 2001 Annual Report to Shareholders at pages 3-29.

ITEM 8. Changes in and Disagreements with Accountants on Accounting and

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Financial Disclosure

There have been no disagreements between the Company and its independent accountants for the past two years.

PART III

ITEM 9. Directors, Executive Officers, Promoters and Control Persons;

Compliance with Section 16(a) of the Exchange Act

This information is incorporated herein by reference from the Company's Proxy Statement for the 2002 Annual Meeting of Shareholders at pages 2 through 4 and page 8 thereof.

ITEM 10. Executive Compensation

This information is incorporated herein by reference from the Company's Proxy Statement for the 2002 Annual Meeting of Shareholders at pages 5 through 8 thereof.

ITEM 11. Security Ownership of Certain Beneficial Owners and Management

This information is incorporated herein by reference from the Company's Proxy Statement for the 2002 Annual Meeting of Shareholders at pages 2 and 4 thereof.

ITEM 12. Certain Relationships and Related Transactions

This information is incorporated herein by reference from the Company's Proxy Statement for the 2002 Annual Meeting of Shareholders at page 8 thereof.

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ITEM 13. Exhibits and Reports on Form 8-K

(a) Exhibit Index:

- #3 (i)Articles of Incorporation and (ii) Bylaws. Incorporated by reference to Exhibits 3.1 and 3.2 of previously filed Registration Statement on Form S-18, Registration No. 33- 27825, dated May 15, 1989, as amended.
- #10 Material Contracts. Exhibits 10.1 - 10.3 are incorporated by reference to Exhibit 10 to previously filed Registration Statement on Form S-18, Registration No. 33- 27825, dated May 15, 1989, as amended.
 - 10.1 Employee Stock Ownership Plan
 - 10.2 Douglas D. Monroe, Jr. Deferred Compensation Agreement
 - 10.3 Thomas B. Denegre, Jr. Deferred Compensation Agreement

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10.4 John H. Hunt, II Employment Agreement (filed with the December 1997 10KSB)

#13 Annual Report to Security Holders is filed herewith

#21 Subsidiaries of the Registrant is filed herewith.

#22 None

(b) Reports on Form 8-K. No reports were filed by the registrant during the fourth quarter of 2001.

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SIGNATURES

In accordance with Section 13 or 15(d) 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.

CHESAPEAKE FINANCIAL SHARES, INC.

Date: March 26, 2002

By /s/ Douglas D. Monroe, Jr.

Douglas D. Monroe, Jr.
Chairman of the Board and
Chief Executive Officer

In accordance with the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ Douglas D. Monroe, Jr. March 26, 2002

Douglas D. Monroe, Jr.
Chairman of the Board and
Chief Executive Officer

/s/ T. Nash Broaddus March 26, 2002

T. Nash Broaddus, Director

/s/ Eugene S. Hudnall March 26, 2002

Eugene S. Hudnall, Director

/s/ Katherine W. Monroe March 26, 2002

Katherine W. Monroe, Director

/s/ Bruce P. Robertson March 26, 2002

Bruce P. Robertson, Director

/s/ William F. Shumadine, Jr. March 26, 2002

William F. Shumadine, Jr., Director

/s/ Robert L. Stephens March 26, 2002

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Robert L. Stephens, Director

/s/

Jeffrey M. Szyperski

March 26, 2002

Jeffrey M. Szyperski, Director