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North State Bancorp (NSBC- OTC Bulletin Board)

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Price:	\$7.00	EPS *	2007A:	\$0.42	P/E	2007A:	16.7 x
52 Wk. Range:	\$8.05 - \$17.50	(FY: DEC)	2008E:	\$ 0.35		2008E:	20.0 x
Div/Div Yld:	\$0.00 / 0.0%		2009E:	\$ 0.42		2009E:	16.7 x
Shrs/Mkt Cap:	7.2 mm / \$50 mm	Book Value:		\$ 4.86	Price/Book Value:		1.44 x

* Earnings per share are diluted. All per share figures have been adjusted for the 50% stock split paid on July 12, 2007.

Background

North State Bancorp ("the Company") is a single bank holding company headquartered in Raleigh, North Carolina with approximately \$633 million in assets at September 30, 2008. Its bank subsidiary is North State Bank, a commercial bank that began operations on June 1, 2000. North State Bancorp serves Raleigh, Garner and Wake Forest, North Carolina through four full-service offices in Raleigh, one office (each) in Garner, the Wake Forest area and a newly opened full-service office in Wilmington, NC. It also opened a loan production office in Morehead in May 2008. The Company focuses on serving the total banking needs of professional firms, professionals, property management companies, churches, nonprofit organizations and individuals who highly value a mutually beneficial banking relationship in the Raleigh, Garner, greater Wake County, New Hanover County and Carteret County market areas. Loan products include business products, such as commercial lines of credit, loans for equipment, owner occupied commercial mortgages and other commercial real estate loans and personal lines of credit, such as home equity loans, first and second mortgages and auto loans. Product deposit services include demand deposits, money market accounts, consumer and business time deposits and sweep accounts. North State Bancorp also offers debit cards, ATM access, home and business banking via the Internet and courier services for businesses. Recent service enhancements include same day banking (i.e., transactions are processed on the same day they occur), telephone banking, lockbox and remote deposit capture capabilities. Insiders own approximately 51% of the outstanding stock.

Third Quarter Earnings Affected By Higher Provision

Although North State Bancorp's earnings were down relative to our projections and the year-ago figures, operating results were actually better than implied by the bottom line given that there was a significantly higher provision for loan losses in the quarter. To be specific, the provision for loan losses increased to \$777,000 in 2008's third quarter from \$255,000 in the year-ago quarter, and versus our projection for the provision of \$450,000. If the provision had come in at the projected level, earnings per share would have been right in line with our estimates.

Net income in 2008's third quarter was \$586,000, or \$0.08 per diluted share, compared to \$931,000, or \$0.13 per diluted share, in the year-ago quarter. Excluding the provision for loan losses in both periods, pretax income actually increased slightly compared to the year-ago quarter. As has been the case with results for the past several quarters, the Company's margin was under pressure but excellent growth in average earning assets more than offset the effects of the lower margin. Specifically, the net interest margin was 3.61% in the third quarter of 2008, which was down 27 basis points from the year-ago quarter, although the 27% increase in average earning assets more than offset the effect of the lower margin. Noninterest income growth was also excellent, increasing 35% to \$395,000 for the third quarter of 2008 from the year-ago quarter and 19% from the level in the second quarter of 2008. Noninterest expense was up 29% to \$3,876,000 in 2008's third quarter, versus \$3,016,000 in the year-ago quarter, mainly due to the Company's expansion activities.

ASSETS: \$633 MM

HQ: RALEIGH, NC

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3RD QUARTER HIGHLIGHTS:

EPS: \$0.08 vs. \$0.13

PRETAX INCOME BEFORE THE PROVISION INCREASED FROM THE YEAR-AGO LEVEL

MARGINS WERE DOWN 27 BASIS POINTS, THOUGH THIS WAS MORE THAN OFFSET BY 27% GROWTH IN VOLUME

NET INTEREST INCOME WAS UP 17%; NONINTEREST INCOME GREW 35% FROM THE YEAR-AGO QUARTER AND WAS UP 19% FROM THE SECOND QUARTER OF 2008

YEAR-TO-DATE HIGHLIGHTS:

EPS: \$0.25 vs. \$0.34

THE PROVISION MORE THAN DOUBLED

FROM SEPTEMBER 30, 2007 TO SEPTEMBER 30, 2008:

ASSETS AND DEPOSITS GREW 29%, AND NET LOANS WERE UP 31%

OF 50 BANKS IN NC, NORTH STATE'S SHARES HAD THE HIGHEST FIVE-YEAR PRICE CHANGE

NSBC FIVE-YEAR PRICE APPRECIATION: 74%; WHILE THE MAJORITY OF NC BANKS HAD NEGATIVE PRICE CHANGES

NPAs INCREASED FROM THE YEAR-AGO DATE AND ON A SEQUENTIAL BASIS, BUT NPAs/ASSETS IS STILL BETTER THAN THE PEER GROUP MEDIAN

NPAs/ASSETS: 0.84%

RESERVES / LOANS HFI: 1.11%

EPS PROJECTIONS

**2007A: \$ 0.42
2008E: \$ 0.35
2009E: \$ 0.42**

As was the case with the quarterly results, earnings for the first nine months of 2008 were lower compared to the year-ago date due to a much higher provision for loan losses, which more than doubled to \$1,874,000 over this period. Net income totaled \$1,858,000, or \$0.25 per diluted share, for the nine months ended September 30, 2008, versus \$2,485,000, or \$0.34 per diluted share, in the year-ago period. Revenue growth was strong, with net interest income growing 20% and noninterest income up 22% from the year-ago period (excluding minimal losses on the sale of securities). Noninterest expense, reflecting several office openings, increased 29% from the year-ago period.

As was implied by the earlier comments, balance sheet growth has remained excellent. From September 30, 2007 to September 30, 2008, assets and deposits increased 29%, while net loans increased 31% to \$533 million. We believe many of the growth prospects have been enhanced by the turmoil surrounding Wachovia and some of the other large banks that have recently garnered so many of the recent headlines. We would also point out that the Company had no investments in Freddie Mac or Fannie Mae stock and has no exposure to subprime loans.

North State Bancorp Has the Highest Five-Year Price Appreciation of All NC Banks

North State Bancorp's long-term stock performance has been excellent. In fact, NSBC shares have the

FIVE YEAR PRICE APPRECIATION		
NSBC	All NC Banks Median	NC Peer Median (assets btwn. \$250MM and \$1B)
73.9%	-20.3%	-13.8%

highest five-year price appreciation of any publicly traded NC bank, of which there were 50. Specifically, North State Bancorp's shares have a price appreciation of 74% on a five-year basis, compared to a negative change of 20% for the median of all NC publicly traded banks. The

median price change was a negative 14% for the Company's NC peer group, which includes NC banks with assets between \$250 million and \$1 billion in assets. Much of that appreciation has been the result of management's successful strategy of identifying specific niches to focus upon and hiring well connected bankers with strong local presences.

Although NPAs Increased, Asset Quality is Better than Most Peers

Although nonperforming assets increased at September 30, 2008, overall asset quality remained better than the majority of the Company's NC peers. NPAs were \$5,320,000, or 0.84% of total assets, at September 30, 2008, versus \$721,000, or 0.15% of total assets, at the year-ago date. A significant portion of NPAs relate to a single practice physician who died unexpectedly, and management has indicated that the credit is fully collateralized. The allowance for loan losses grew 38% to \$6,004,000, or 1.13 times NPAs, at the end of 2008's third quarter, from \$4,358,000, or 6.04 times NPAs, at the year-ago date. Though NPAs increased, both the NPAs-to-assets and reserves-to-NPAs ratios were superior to the NC peer group median. The only ratio that was below the peer median was reserves as a percentage of loans held for investment, which was 1.11% at September 30, 2008.

ASSET QUALITY VS. PEERS		
	NSBC	NC Peer Median
NPAs/Assets	0.84%	1.06%
Res./NPAs	1.13x	0.78x
Res.Loans HFI	1.11%	1.31%

Projections

We are slightly lowering our projections for 2008 and 2009. For 2008, we estimate earnings of \$2.5 million, or \$0.35 per diluted share (versus \$0.40 per share previously), and for 2009, we project net income of \$3.1 million, or \$0.42 per diluted share (versus \$0.52 per diluted share). For more information, including current press releases and stock quotes, please visit either North State Bancorp's web site at www.northstatebank.com, or Equity Research Services' web site at www.equityresearch.com.

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