

North State Bancorp (Not Publicly Traded)

John A. (Buddy) Howard, CFA
August 17, 2023

107 Windel Dr., Suite 211

Raleigh
North Carolina
27609

919-876-8868 ph

Price: *	\$16.35	EPS *	2021A:	\$2.64	P/E	2021A:	6.2x
52 Wk. Range:	\$16.35 - 16.55	(FY: DEC)	2022A:	\$2.08		2022A:	7.9x
Distributions (Estimated):*	\$1.26		2023E:	\$1.64		2023E:	10.0x
Shares:	6.5 mm	Book Value:		\$11.55	Price/Book Value:		1.42x

* Stock is not actively traded. Last known trade. Tangible book value is \$11.23. Distributions are estimates based on 70% of EPS.

www.equityresearch.com

Background

North State Bancorp (the “Company”) is a single bank holding company headquartered in Raleigh, North Carolina with approximately \$1.3 billion in assets as of June 30, 2023. Its bank subsidiary is North State Bank, a commercial bank that began operations on June 1, 2000. North State Bancorp serves Wake and New Hanover Counties through seven full-service offices. The Company focuses on serving the total banking needs of small businesses and individuals, professional firms, professionals, property management companies, churches, non-profits and any others who value a mutually beneficial banking relationship. Market areas include Raleigh, Garner, greater Wake County and New Hanover County. The Company is an S-Corporation for tax purposes.

Second Quarter Earnings Exceeded our Projections

For the three months ended June 30, 2023, North State Bancorp reported another good quarter, punctuated by modestly higher earnings that exceeded our estimates. The earnings growth was due to a combination of strong net interest income, which benefited from ongoing net interest margin momentum, as well as a recovery for loan losses in 2023’s second quarter. Loans continued to lead overall balance sheet growth, as cash, deposits and total assets contracted relative to year-ago figures. From an asset quality standpoint, it was also an encouraging quarter, as nonperforming assets were up compared to the year-ago date but dropped substantially from the level as of March 31, 2023.

In terms of specifics, North State reported net income of \$3,294,000, or \$0.51 per share, in the second quarter of 2023, versus \$3,161,000, or \$0.51 per share, in the year-ago quarter. As was mentioned above, net interest income was a key driver of the earnings improvement, increasing 11% to \$12,238,000 in 2023’s second quarter from \$11,018,000 in the year-ago quarter. This growth was entirely due to improvement in the net interest margin, which grew to 4.00% in 2023’s second quarter from 3.17% in 2022’s second quarter (average earning assets were down, as expected, about 12%). Earnings also benefitted from a recovery for credit losses of \$441,000, compared to a provision for credit losses of \$200,000 in 2022’s second quarter, reflecting the Bank’s strong loan position and the change in reserve requirements pursuant to new CECL (current expected credit losses) accounting standards.

Noninterest income continued to be negatively impacted by lower mortgage fees and SBA income, totaling \$2,367,000 in 2023’s second quarter, versus \$3,331,000 in the year-ago quarter. (We expect trends in noninterest income to remain challenging while interest rates remain high.) Noninterest expense was \$11,752,000 for the second quarter of 2023, which was up 7% from \$10,988,000 in the year-ago quarter, with the growth mainly due to higher salary and employee benefits and data processing and other outsourced services. Profitability metrics remained quite impressive. Return on average equity was 18.02% in 2023’s second quarter, while return on average assets was 1.01%.

For the first six months of 2023, net income was \$6,878,000, or \$1.07 per share, up 14% from \$6,028,000, or \$0.97 per share, in the year-ago period. Strong net interest income growth of 21% more

ASSETS: \$1.3 BB

HQ: RALEIGH, NC

CONTACT:
STACY REEDY
(919) 278-2301

2ND QUARTER HIGHLIGHTS:

EARNINGS EXCEEDED PROJECTIONS BY \$0.02 PER SHARE

EPS: \$0.51 VS. \$0.51 IN THE YEAR-AGO QUARTER

THERE WAS A RECOVERY OF CREDIT LOSSES IN THE AMOUNT OF \$441,000 VS. A PROVISION FOR CREDIT LOSSES OF \$200,000 IN THE YEAR-AGO QUARTER

NET INTEREST INCOME WAS UP 11%

THE NET INTEREST INCOME GROWTH WAS DUE TO MARGIN IMPROVEMENT, WHICH OFFSET LOWER AVERAGE EARNING ASSETS

FIRST HALF HIGHLIGHTS:**EPS: \$1.07 vs. \$0.97****NET INTEREST INCOME INCREASED 21%, WHICH MORE THAN OFFSET A DECLINE IN NONINTEREST INCOME****OVER THE PAST TEN YEARS, ASSETS, LOANS AND DEPOSITS HAVE DOUBLED****LOAN GROWTH HAS BEEN ESPECIALLY STRONG****NET INCOME HAS NEARLY QUADRUPLED IN THE LAST DECADE****ASSET QUALITY HAS SHOWN STRONG IMPROVEMENT AS WELL****NPAs/ASSETS: 0.23%, DOWN FROM 0.46% AS OF 3/31/23****RESERVES/LOANS: 0.65%****EPS:
2021A: \$ 2.64
2022A: \$ 2.08
2023E: \$ 1.64**

than offset a 37% decline in noninterest income over these respective periods, while noninterest expense grew 7%. Loan growth was the leader in terms of balance sheet expansion, increasing 11% to \$1.1 billion as of June 30, 2023 relative to the year-ago date, while total assets were down 10% and deposits contracted 11% over this period. We do not expect overall balance sheet growth to be very high in coming quarters, reflecting some run-off in deposits, though loan demand has been holding up relatively well. Shareholders' equity totaled \$74.9 million as of June 30, 2023, or 5.59% of total assets, versus \$67.1 million, or 4.51% of total assets, as of the year-ago date.

North State Bancorp's Historical Growth is Impressive

While North State's most recent results were solid, it bears mentioning that its historical growth is just as impressive. As can be seen from the adjacent table, over the past ten years, assets, loans and deposits roughly doubled. Over the same period, North State has added 57 employees, largely in its commercial banking area. Both

loans and deposits increased as a percentage of total assets as well. In terms of performance measures, net income has had excellent growth over the past ten years, nearly quadrupling and growing at an annualized rate of nearly 17%, which is especially impressive for such an extended period. Several key performance metrics likewise improved. (While some of the increase in ROAA and ROAE was due to current earnings being untaxed, those measures still improved even on a taxable equivalent basis.) Lastly, asset quality has

North State Bancorp, Ten Year Growth Analysis				
	Q2 2013	Q2 2023	% Gr. '13-'23	CAGR '13-'23
Balance Sheet Highlights (\$Billions except FTE & %)				
Total Assets	0.687	1.341	95.2%	6.9%
Total Loans	0.492	1.105	124.5%	8.4%
Total Loans/Assets (%)	77.4	82.4		
Total Deposits	0.615	1.218	97.9%	7.1%
Deposits/Assets (%)	89.5	90.8		
Full-time Employees	145	202	39.6%	3.4%
Performance Measures (% except Net Inc. in \$MM)				
Net Income	0.695	3.294	374.0%	16.8%
ROAA (%)	0.40	1.01		
ROAE (%)	4.95	18.02		
Net Interest Margin (%)	3.37	4.00		
Efficiency Ratio (FTE) (%)	81.38	80.47		
Asset Quality (%)				
NPA Excluding Restructured Loans/ Total Assets	1.89	0.23		
Loan Loss Reserves/ Gross Loans	1.56	0.65		
Reserves/ NPAs	47.67	231.59		
Net Chargeoffs/ Avg Loans	0.48	-0.02		

had stellar improvement over the last ten years, with NPAs/assets significantly decreasing, while reserves/NPAs increased. We are particularly impressed with North State's long-term performance given the markets it operates in (the Raleigh-Durham-Chapel Hill area and Wilmington, NC), both of which are extremely competitive.

Nonperforming Assets Were Down 48% From March 31, 2023

At the end of the first half of 2023, North State Bancorp reported nonperforming assets (which consisted of \$2.6 million in nonaccrual loans and \$0.5 million in foreclosed assets) of \$3.1 million, or 0.23% of total assets, which was down 48% from \$5.9 million, or 0.46% of total assets, as of March 31, 2023, and compared to \$2.3 million, or 0.15% of total assets, at the year-ago date. The allowance for credit losses was \$7.1 million, or 0.65% of total loans, as of June 30, 2023, up from \$7.0 million (0.70% of total loans) at the year-ago date.

Projections

Based on industry-wide pressures on the cost of funding, most banks are experiencing margin pressures. North State Bancorp is no exception. Based on this pressure, as well as the industry-wide mortgage and SBA slowdown from higher interest rates, we are revising our 2023 earnings projections to \$10.5 million, or \$1.64 per share. Actual earnings could vary substantially from these projections given volatile interest rates and other economic uncertainties.

ADDITIONAL INFORMATION UPON REQUEST

Copyright © 2023 Equity Research Services, Inc. All rights reserved. This material is for your information only and is not a solicitation, or an offer, to buy or sell securities mentioned. Equity Research Services, Inc. ("ERS") is a firm involved in financial advisory, equity research, valuation and investor relations services. All reports generated by ERS for the purpose of investor relations are designated "Investor Relations Report," and ERS receives a fee (from the company whose securities are described) for producing such reports. ERS may also act in a financial advisory role to the company. The information contained herein has been obtained from sources we believe reliable but in no way is guaranteed by us. Furthermore, this report contains forward-looking statements and projections that are based on certain assumptions and expectations. Accordingly, actual results may differ considerably from those reflected in this report due to such factors as those which are listed in the Company's SEC filings. Any non-factual information in the report is our opinion and is subject to change without notice.