

North State Bancorp (Not Publicly Traded)

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ASSETS: \$1.5 BB

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1ST QUARTER HIGHLIGHTS:

AS WAS EXPECTED, EARNINGS DECLINED DUE TO LOWER PPP-RELATED FEES AND A SLOWDOWN IN THE MORTGAGE AREA

OTHER AREAS REFLECTED STRENGTH, HOWEVER, AND ROAE WAS STILL AN IMPRESSIVE 17.92%

EPS: \$0.46 vs. \$0.97

NET INTEREST INCOME DECREASED 8% BUT WOULD HAVE INCREASED EXCLUDING PPP-RELATED FEES

THE MARGIN WAS DOWN 76 BASIS POINTS, WHICH WAS PARTIALLY OFFSET BY 17% GROWTH IN AVERAGE EARNING ASSETS

Price: *	\$19.75	EPS *	2020A:	\$2.53	P/E	2020A:	7.8x
52 Wk. Range:	N/A	(FY: DEC)	2021A:	\$2.64		2021A:	7.5x
Distributions (Estimated):*	\$1.45		2022E:	\$2.07		2022E:	10.0x
Shares:	6.2 mm	Book Value:		\$10.50	Price/Book Value:		1.88x

* Stock is not actively traded. Last known trade. Tangible book value is \$10.16. Distributions are estimates based on 70% of EPS.

Background

North State Bancorp (the “Company”) is a single bank holding company headquartered in Raleigh, North Carolina with approximately \$1.5 billion in assets as of March 31, 2022. 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.

There Were Several Key Accomplishments in the First Quarter of 2022 Despite Earnings Decline

As we had anticipated, North State Bancorp reported lower earnings in the first quarter of 2022 compared to the year-ago quarter, though we were pleased with the quarter on several fronts. First, net income was up sharply (25%) on a linked quarter basis from 2021’s fourth quarter, earning asset growth was strong and partially offset margin compression. Second, even though noninterest income dropped relative to the year-ago quarter due to lower mortgage operations revenue, other components of noninterest income had solid growth. Third, balance sheet momentum was solid, with notable showings in both loans and deposits. Fourth, we would note that overall asset quality continued to improve, with nonperforming assets remaining in a clear downtrend. Finally, despite the lower earnings, the Company’s ROAE was still an impressive 17.92% in 2022’s first quarter, versus 14.10% in the fourth quarter of 2021 and 40.02% in the year-ago quarter. (The year-ago quarter included significant PPP-related income, as well as unusually strong mortgage results driven by favorable market and rate economics.)

In terms of the specific quarterly results, North State had net income of \$2,867,000, or \$0.46 per share, for the first quarter of 2022, versus \$5,936,000, or \$0.97 per share, in the year-ago quarter. The



softness in earnings was mainly due to lower net interest income and noninterest income. Net interest income totaled \$9,581,000 in 2022’s first quarter, which was down 8% from \$10,435,000 in the year-ago quarter, although essentially all of that shortfall was due to higher PPP-related fees in the year ago quarter. Specifically, there was \$141,000 in PPP-related fees in 2022’s first quarter, versus roughly \$1.26 million in the year-ago quarter. Excluding PPP-related fee income, net interest income would actually have increased in the low single digits between the two periods. Margins have generally been under pressure (they were 2.79% in 2022’s first quarter, versus 3.55% in the year-ago quarter), though

that margin pressure was offset by strong comparisons in average interest earning assets (up 17%), as can be seen in the adjacent chart. Looking ahead, we expect average earning assets growth to slow but for margins to improve, partly due to expected Federal Reserve rate hikes. Another major factor in the results was noninterest income, which declined 43% to \$3,724,000 in 2022’s first quarter, versus \$6,511,000 in the year-ago quarter. Fees from mortgage operations, which accounted for the majority

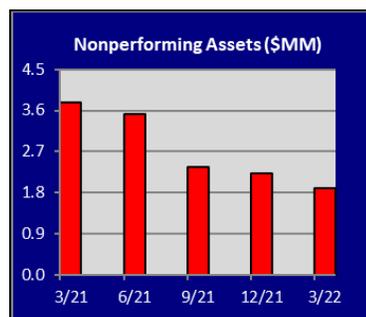
on noninterest income, were \$1,828,000 in the first quarter of 2022 versus a year-ago quarterly figure of \$4,736,000. Importantly, even though mortgage fees were much lower, the mortgage operation was still quite profitable, and actually accounted for about 21% of *net* income. It was also encouraging that fees from mortgage operations did increase 7% from 2021's fourth quarter level. Other areas of noninterest income showed positive trends from the year-ago quarter, such as gains from SBA operations sales (+3%), deposit service charges (+35%) and fees from wealth management services (+64%). Cost wise, North State did a good job of containing expenses during the quarter, as noninterest expense was up less than 1% to \$10,438,000 in the first quarter of 2022. Finally, we would note that there was no provision for loan losses in 2022's first quarter, as asset quality remained strong and allowance coverage ratios were already adequate, compared to a provision of \$660,000 in the first quarter of 2021.

Deposits and Deposit Market Share Continue to Grow in the Wake County Market

Balance sheet growth over the past twelve months was impressive. From March 31, 2021 to March 31, 2022, deposits increased 16% and total assets grew 15%, with core deposits (which exclude internet, CDARs, brokered CDs and CDs over \$100,000) growing 17% over this period. And while loans technically "only" increased 2%, that was net of significant payoffs of PPP loans, so loan origination activity has actually been quite commendable. With the large amount of cash and securities in the Bank (cash and securities accounted for nearly 30% of assets at March 31, 2022, versus roughly 20% at the year-ago date), North State is in excellent shape to fund future loan growth. North State has also been putting a number of growth initiatives in place. For example, it has made several key hires over the past year (14 were either new hires or promotions, many in relationship banking and commercial lending). Moreover, it will also be upgrading a West Raleigh location later this year. These initiatives should help the Bank to sustain loan growth, as well as to continue its strong record of building deposits. From a capital standpoint, all of the Bank's regulatory capital ratios exceed "well capitalized" minimums. Shareholders' equity as of March 31, 2022 was \$65 million, or 4.5% of total assets. We expect the capital ratio to increase as total asset growth moderates and ROE remains (based on our projections) relatively high.

NPAs Continue to Decline, Asset Quality is Superior to Peers

As displayed in the adjacent chart, North State's nonperforming assets ("NPAs") continued to trend downward and were \$1,900,000, or 0.13% of total assets, at March 31, 2022, which was down from \$2,224,000, or 0.16% of total assets, at December 31, 2021, and \$3,859,000, or 0.30% of total assets, at the year-ago date. The recent NPA-to-assets percentage



remains better than the comparable figures for other peer banks, which we define as NC, SC and VA banks

	North State 3/31/21	North State 3/31/22	Peer Group
Median			
NPAs/Assets (%)	0.30	0.13	0.18
Reserves/NPAs (x)	1.88	3.57	1.94
Reserves/Loans (%)	0.78	0.71	1.15

with assets between \$500 million and \$5 billion. The allowance for loan losses totaled \$6,781,000 (0.71% of total loans) at March 31, 2022, versus \$7,267,000 (0.78% of total loans) as of the year-ago date.

Projections

We are estimating North State Bancorp will earn \$12.9 million, or \$2.07 per share for the year 2022. While this is down from 2021's earnings of \$16.2 million, 2022 projections only include less than \$200,000 in expected PPP fees, versus \$4.2 million in 2021 and mortgage income is expected to be lower as well. Actual earnings could vary substantially from these projections given the economic uncertainties.

ADDITIONAL INFORMATION UPON REQUEST

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**MORTGAGE OPERATIONS
INCOME WAS DOWN 61%**

**NONINTEREST EXPENSE
INCREASED LESS THAN 1%**

**FROM MARCH 31, 2021 TO
MARCH 31, 2022:**

**NET LOANS GREW 2%, DESPITE
RAPID PAYOFFS OF PPP**

DEPOSITS INCREASED 16%

TOTAL ASSETS WERE UP 15%

**SEVERAL NEW GROWTH
INITIATIVES HAVE BEEN
ADOPTED THAT SHOULD
BENEFIT LONG-TERM GROWTH**

**NPAS DECREASED 15% FROM
12/31/21 AND 51% FROM THE
YEAR-AGO DATE**

**NPAS/ASSETS: 0.13% VS. 0.30%
AT THE YEAR-AGO DATE AND
0.18% FOR THE NC PEER
GROUP MEDIAN**

RESERVES/LOANS: 0.71%

EPS:
2020A: \$ 2.53
2021A: \$ 2.64
2022E: \$ 2.07