

## North State Bancorp (Not Publicly Traded)

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North Carolina  
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|                                   |         |                    |               |        |                          |               |       |
|-----------------------------------|---------|--------------------|---------------|--------|--------------------------|---------------|-------|
| <b>Price: *</b>                   | \$16.00 | <b>EPS</b>         | <b>2018A:</b> | \$1.65 | <b>P/E</b>               | <b>2018A:</b> | 9.7x  |
| <b>52 Wk. Range:</b>              | N/A     | (FY: DEC)          | <b>2019A:</b> | \$1.95 |                          | <b>2019A:</b> | 8.2x  |
| <b>Distributions (Estimated):</b> | \$1.65  |                    | <b>2020E:</b> | \$2.35 |                          | <b>2020E:</b> | 6.8x  |
| <b>Shares:</b>                    | 6.0 mm  | <b>Book Value:</b> |               | \$8.92 | <b>Price/Book Value:</b> |               | 1.79x |

\* Stock is not actively traded. Last known trade. Tangible book value is \$8.59.

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### Background

North State Bancorp (the “Company”) is a single bank holding company headquartered in Raleigh, North Carolina with approximately \$1.2 billion in assets as of September 30, 2020. 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 and non-profits who highly value a mutually beneficial banking relationship. Market areas include Raleigh, Garner, greater Wake County and New Hanover County. Product deposit services include demand deposits, savings, money market accounts, consumer and business time deposits and sweep accounts. Loan products include business products, such as commercial lines of credit, lease financing, loans for equipment and owner-occupied commercial mortgages and other commercial real estate loans and personal lines of credit, such as home equity loans and first and second mortgages. North State Bancorp also offers online mobile banking, digital banking, cash management, payroll and merchant services, in addition to courier services for businesses, same day banking (i.e., transactions are processed on the same day they occur), lockbox and remote deposit capture capabilities. Additional service enhancements include a Mortgage Division, staffed by experienced mortgage professionals; CommunityPLUS, a division serving property management firms throughout North Carolina and other states with companies who have a close working relationship with the Bank, and an SBA and USDA Lending division, which allows the Bank to fund loans for owner-operated businesses, on a nationwide basis. (North State has been granted “preferred lender” status from the SBA, which allows it to have greater flexibility and often expedited processing times when considering a borrower’s risk profile.) The Company is an S-Corporation for tax purposes.

### Pretax Income Before the Provision & Net Foreclosed Asset Expense Was Up 47%

North State reported solid results in the third quarter of 2020. Although earnings were lower than in the year-ago quarter, that decline was due to a large increase in the provision for loan losses, reflecting management’s intention to more defensively position the Company given COVID-19 and the potential for further economic weakness. In that regard, it has already been making considerable progress: the allowance for loan losses was up 71% in the past twelve months, and reserves/loan ratios have significantly strengthened. It was also a good quarter from the standpoint of revenue growth, with a particularly strong showing in fees from mortgage operations. We continue to believe this area (mortgage) has great potential for North State, partly because of the success in the past but also based on the Company’s ability to quickly scale (up or down) personnel and expenses in accordance with mortgage activity. Reflecting this strong revenue growth, “normalized” profitability was quite strong in 2020’s third quarter relative to the year-ago quarter. In fact, the pre-provision income before foreclosed asset expense was up 47% from the year-ago level. Balance sheet growth (even excluding PPP) and asset quality were also quite good.

**ASSETS: \$1.2 BB**

**HQ: RALEIGH, NC**

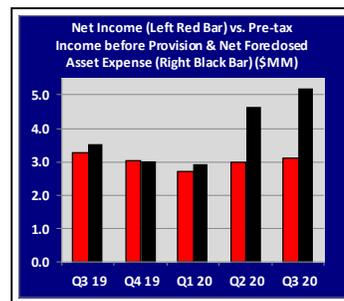
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**3<sup>RD</sup> QUARTER HIGHLIGHTS:**

**THE PROVISION INCREASED DUE TO COVID-19**

**WHILE NET INCOME WAS DOWN, INCOME BEFORE THE PROVISION AND FORECLOSED ASSET COSTS INCREASED 47%**

**REVENUE GROWTH WAS EXCEPTIONAL**



**EPS: \$0.51 vs. \$0.55**

**EPS WAS \$0.17 ABOVE ESTIMATES**

**STRONG VOLUME GROWTH OF 32% IN AVERAGE EARNING ASSETS OFFSET A DECREASE IN MARGINS**

**NONINTEREST INCOME HAD EXCELLENT GROWTH OF 78%**

**YTD 2020 HIGHLIGHTS:**

**NET INCOME INCREASED 3%**

**INCOME BEFORE THE PROVISION/NET FORECLOSED ASSET EXPENSE WAS GREW 37%**

**FROM 9/30/19 TO 9/30/20: NET LOANS INCREASED 25%, DEPOSITS INCREASED 21% AND TOTAL ASSETS WERE UP 31%**

**CORE DEPOSITS WERE UP 21% OVER THE PAST YEAR**

**NPAs WERE UP FROM THE YEAR-AGO DATE BUT DECREASED FROM 6/30/20**

**NPAs/ASSETS: 0.41%**

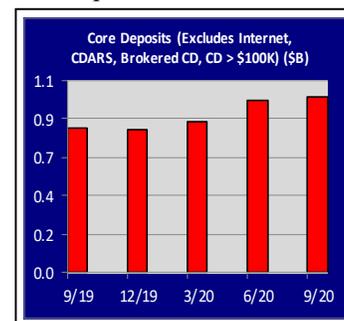
**RESERVES/LOANS: 0.88%**

**EPS:  
2018A: \$ 1.65  
2019A: \$ 1.95  
2020E: \$ 2.35**

In terms of specific results, net income for the third quarter of 2020 was \$3,107,000, or \$0.51 per share, versus \$3,258,000, or \$0.55 per share, in the year-ago quarter. Actual earnings per share outperformed our projections significantly. As was stated earlier, the provision for loan losses was much higher than usual, totaling \$2,070,000 in 2020's third quarter, versus \$260,000 in the year-ago quarter. Net interest income grew 7% to \$9,914,000 in 2020's third quarter from \$9,273,000 in the year-ago quarter, with strong growth of 32% in average earning assets more than offsetting lower margins, which were 3.33% in 2020's third quarter versus 4.40% in the year-ago quarter. (Margins contracted due to the 1% fixed interest rate on PPP loans and the low overall level of interest rates.) One of the brightest spots of the quarter was noninterest income, which was up 78% to \$7,142,000 in the third quarter of 2020 from \$4,009,000 in the year-ago quarter. Fees from the mortgage operations more than doubled to \$6,168,000 from \$2,347,000 in 2020's third quarter relative to the year-ago quarter, more than offsetting declines in fees and gains on SBA and transaction accounts. Finally, noninterest expense was up 22% from the year-ago quarter, due to higher salaries and employee benefits, much of which related to the high mortgage origination activity. We were also impressed with North State's profitability metrics, as ROAA was 1.04% in 2020's third quarter, while ROAE was 22.28%.

**YTD 2020 "Core" Income Was Up 37%**

Earnings for the first nine months of 2020 were likewise impacted by a higher provision, which totaled \$3,940,000, compared to \$680,000 in the first nine months of 2019. Reported net income was \$8,847,000, or \$1.47 per share, up 3% from \$8,579,000, or \$1.44 per share, in the year-ago period. Earnings before the provision and net foreclosed asset expense were up 37% over this period. Net interest income grew 3%, noninterest income increased an excellent 85% and noninterest expense was up 19% compared to year-to-date 2019 figures. Balance sheet growth was also quite robust. From September 30, 2019 to September 30, 2020, net loans were up 25%, deposits increased 21% and total assets grew 31%. We would also note that core deposits, which exclude internet, CDARS, brokered CDs and CDs over \$100,000, increased 21% from the year-ago date, as displayed in the adjacent chart. Shareholders' equity was \$53.8 million, or 4.33% of total assets, at September 30, 2020.



**Nonperforming Assets Decreased 6% from June 30, 2020**

Although nonperforming assets ("NPAs") were up compared to the year-ago date, they declined on a linked quarter basis. Specifically, NPAs (which exclude restructured loans) were \$5.1 million, or 0.41% of total assets, at September 30, 2020, which was down 9% from \$5.6 million, or 0.46% of total assets, at June 30, 2020, but up from \$0.7 million, or 0.07% of total assets, at the year-ago date. All of the NPAs were nonaccrual loans. The allowance for loan losses totaled \$8.4 million, or 0.88% of total loans, at September 30, 2020, up 71% from \$4.9 million, or 0.64% of total loans, at the year-ago date. The allowance as a percentage of non-PPP loans (PPP loans are guaranteed) was 1.01% as of September 30, 2020.

**Projections**

We expect the provision to be higher than normal for the next few quarters, though the fees from PPP loans (which total around \$4.5 million and will be recognized over the lives of the loans) are likely to offset this increase. While projections remain difficult to gauge, we are estimating 2020 earnings of \$14.1 million, or \$2.35 per share. As stated previously, actual earnings could vary substantially from these projections given the uncertainties of the COVID-19 crisis.

**ADDITIONAL INFORMATION UPON REQUEST**

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