

## North State Bancorp (Not Publicly Traded)

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**October 28, 2022**

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North Carolina  
27609

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<b>Price: *</b>	\$16.55	<b>EPS *</b>	<b>2020A:</b>	\$2.53	<b>P/E</b>	<b>2020A:</b>	6.3x
<b>52 Wk. Range:</b>	\$16.55 – 19.75	(FY: DEC)	<b>2021A:</b>	\$2.64		<b>2021A:</b>	8.0x
<b>Distributions (Estimated):*</b>	\$1.45		<b>2022E:</b>	\$2.07		<b>2022E:</b>	8.0x
<b>Shares:</b>	6.3 mm	<b>Book Value:</b>		\$10.91	<b>Price/Book Value:</b>		1.52x

\* Stock is not actively traded. Last known trade. Tangible book value is \$10.56. Distributions are estimates based on 70% of EPS.

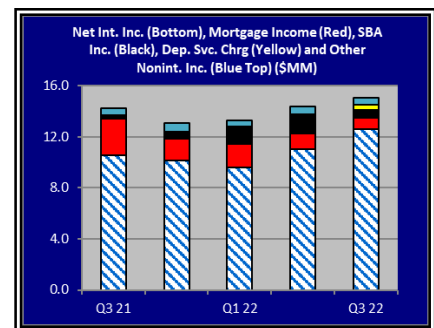
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### Background

North State Bancorp (the “Company”) is a single bank holding company headquartered in Raleigh, North Carolina with approximately \$1.4 billion in assets as of September 30, 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.

### Third Quarter Results Slightly Beat Projections, Pre-Provision/Pre-PPP Earnings Up 44%

North State Bancorp posted encouraging third quarter results relative to the year-ago period, although there were several factors that made the comparisons challenging. For example, there has been a significant slowdown in the entire mortgage banking industry, resulting in lower mortgage fees at the Bank. Additionally, there were significant PPP deferred fees in the year-ago quarter, as well as an increase in this year’s provision for loan losses (due to the strong loan growth). While these factors led to a modest drop in earnings from the year-ago figures, we would note that the stated results were actually better than our projections (a penny above), and many of the underlying earnings drivers remain decidedly positive. Revenues were up about 5%, with strong growth in net interest income (bottom stripe in adjacent chart) more than offsetting the drop in mortgage income (shown in red), and several other types of noninterest income were strong.



As we have stated previously, we continue to be impressed with North State’s diversification of income sources. Other notable achievements included strong loan growth over the past year and solid asset quality.

In terms of specifics, North State Bancorp reported net income of \$3,444,000, or \$0.55 per share, for the third quarter of 2022, as compared to \$3,602,000, or \$0.59 per share, in the year-ago quarter. If we exclude the provision (which was \$405,000 in 2022’s third quarter, versus \$250,000 in the year-ago quarter) and the net PPP loan fee accretion (none in the current quarter, versus \$1,172,000 in the year-ago quarter), we see that pretax, pre-PPP earnings increased an impressive 44%. Net interest income increased 19% to \$12,588,000 in 2022’s third quarter from \$10,566,000 in the year-ago quarter, reflecting significant improvement in the net interest margin (it increased to 3.65% from 3.28% in the year-ago quarter), as well as 3% growth in average earning assets. Noninterest income was \$2,438,000 in 2022’s third quarter, down from \$3,692,000 in the year-ago quarter. All of that drop was due to the mortgage banking softness (mortgage income was \$909,000 in 2022’s third quarter

Quarterly Results (\$000s)	2021 Q3	2022 Q3
Net Income	3,602	3,444
Adjustments:		
Provision (Add/Deduct Credits)	250	405
Net PPP Loan Fee Accretion	(1,172)	-
<b>Net Inc. Bef. Prov. &amp; PPP Fees</b>	<b>2,680</b>	<b>3,849</b>

**ASSETS: \$1.4 BB**

**HQ: RALEIGH, NC**

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

**EPS: \$0.55 vs. \$0.59**

**A DROP IN MORTGAGE FEE INCOME WAS OFFSET BY STRONG GROWTH IN OTHER AREAS OF NONINTEREST INCOME**

**WHILE EARNINGS WERE LOWER, INTEREST INCOME INCREASED**

**THERE WERE SUBSTANTIAL NET PPP FEES IN THE YEAR-AGO QUARTER, AS WELL AS A HIGHER PROVISION IN Q3 '22**

**EXCLUDING THESE TWO ITEMS, EARNINGS WOULD HAVE INCREASED 44%**

**NET INTEREST INCOME INCREASED 19%, DRIVEN BY HIGHER RATES ON OVERNIGHT BALANCES AND ORGANIC LOAN GROWTH**

**SBA INCOME TRIPLED AND DEPOSIT SERVICE CHARGES WERE ALSO QUITE STRONG**

**THE ROAA WAS 0.95% AND THE ROAE WAS 20.16%**

**FIRST NINE MONTHS HIGHLIGHTS:**

**EPS: \$1.52 VS. \$2.26**

**NET INTEREST INCOME GREW 8%**

**FROM 9/30/21 TO 9/30/22:**

**NET LOANS WERE UP 14%, WHILE DEPOSITS AND TOTAL ASSETS GREW 4%**

**LOANS GREW AT AN ANNUALIZED RATE OF 10% OVER THE PAST EIGHT YEARS**

**LOANS HAVE LARGELY BEEN FUNDED BY DEPLOYING CASH**

**EQUITY/ASSETS: 5.0%**

**NPAS/ASSETS: 0.19%**

**RESERVES/LOANS: 0.72%**

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

versus \$2,853,000 in the year-ago quarter). Bottom line, there was good strength in several non-mortgage areas, most notably SBA operations and service charges. Noninterest expense totaled \$11,177,000 in 2022's third quarter, up from \$10,406,000 in the year-ago quarter. Profitability ratios remained excellent. Return on average assets in 2022's third quarter was 0.95%, while return on average equity was 20.16%.

Results for the nine months of 2022 were similar to the quarterly results in that they were impacted by a higher provision for loan losses, differing net PPP fee accretion amounts (\$0.2 million year-to-date in 2022 versus \$3.3 million in 2021's comparable period) and lower mortgage operations income. Reported net income for the nine months ended September 30, 2022 was \$9.5 million, or \$1.52 per share, as compared to \$13.9 million, or \$2.26 per share, in the year-ago period. The primary driver of that drop was a \$6.5 million decline in mortgage operations. Net interest income grew 8%, noninterest income was down 35% (due to the decrease in mortgage operations) and noninterest expense increased 5%. A higher provision for loan losses also affected the comparisons, as the provision was \$605,000 in the first nine months of 2022, as opposed to \$360,000 in the year-ago year-to-date period.

### **Historical Loan Growth is Excellent, While More Recent Growth Was a Strong 14%**



Balance sheet growth from September 30, 2021 to September 30, 2022 was led by loans, which grew 14% over this period, while both deposits and total assets were up 4% over the past year. We would note that nearly all of this growth in the last year was organic, as PPP loans have rolled off the books. North State has historically had excellent loan growth, as can be seen from the adjacent chart. Over the past eight years from 2014 to 2022, loans grew at an annualized rate of 10%. Much of the recent loan growth has been accomplished by deploying funds from lower yielding cash and interest-bearing bank deposits into (higher yielding) loans, which is good in that improves overall yields/earnings. We would also note that North State's fixed income portfolio is primarily classified as Held to Maturity, which has limited the "other comprehensive loss" that many banks are currently reflecting on securities available for sale. The Company remained well-capitalized at September 30, 2022, with all of the Bancorp's regulatory capital ratios exceeding "well capitalized" minimums. Shareholders' equity was \$68.9 million, or 5.0% of total assets, up from \$64.8 million, or 4.9% of total assets, at the year-ago date.

### **The Allowance for Loan Losses Increased 6%**

As of September 30, 2022, North State Bancorp had nonperforming assets (all of which were nonaccrual loans) of \$2,631,000, or 0.19% of total assets, versus \$2,258,000, or 0.15% of total assets, as of June 30, 2022, and \$2,363,000, or 0.18% of total assets, at the year-ago date. Although this represents an increase from prior quarter and year date, we would note that the Bank has actually had net recoveries so far this year. The allowance for loan losses totaled \$7,456,000, or 0.72% of total loans, as of September 30, 2022, versus \$7,065,000 (0.79% of total loans) at the year-ago date.

### **Projections**

We are maintaining our earnings estimates for the year 2022 of \$12.9 million, or \$2.07 per share. We would also note that while the 2022 figures are down from 2021's earnings of \$16.2 million, 2022 projections only include \$173,000 in PPP fees, versus \$4.2 million in 2021, and mortgage income declined significantly as well. Actual earnings could vary substantially from these projections given the economic uncertainties.

ADDITIONAL INFORMATION UPON REQUEST

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