

North State Bancorp (Not Publicly Traded)

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Raleigh
North Carolina
27609

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Price: *	\$13.00	EPS **	2016A:	\$1.80	P/E	2016A:	NA
52 Wk. Range:	N/A	(FY: DEC)	2017A:	\$1.60		2017A:	NA
Distributions (Estimated):	\$1.20		2018E:	\$ 1.88		2018E:	NA
Shares:	5.8 mm	Book Value: ***		\$7.35	Price/Book Value:		NA

* Stock is not actively traded. Last known trade. ** Earnings per share are diluted. *** Tangible book value is \$7.16 per share.

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Background

North State Bancorp (the “Company”) is a single bank holding company headquartered in Raleigh, North Carolina with approximately \$878 million in assets as of March 31, 2018. 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 professional firms, professionals, property management companies, churches, non-profits, small businesses and individuals 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, money market accounts, consumer and business time deposits and sweep accounts. Loan products include business products, such as commercial lines of credit, 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 located throughout key North Carolina markets; CommunityPLUS, a division serving property management firms throughout the nation, and an SBA and USDA Lending division, which allows the Bank to fund loans for owner-operated businesses, also 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.

First Quarter Results Were Excellent

North State Bank reported another outstanding first quarter. Earnings were up sharply, thanks to strong showings in both net interest income and noninterest income. Balance sheet growth was also excellent, with commendable increases in assets, loans, deposits and stockholders’ equity. And finally, asset quality was excellent, with the overall level of NPAs dropping on a linked quarter and year-ago basis and being at the lowest level they have been in more than a decade.

Net income for the first quarter of 2018 totaled \$2,135,000, or \$0.37 per diluted share, versus \$1,898,000, or \$0.33 per diluted share, in the year-ago quarter. While this growth (12%) was impressive, it is even more notable given that the provision for loan losses was \$250,000 in 2018’s first quarter, versus a *credit* of \$146,000 in the year-ago quarter. (The increase in the provision was due to loan growth, not slippage in asset quality.) In fact, if we eliminate the effects of the provision, we note that the pre-provision income was actually up about 36% to \$2,385,000 in 2018’s first quarter. Net interest income surged in the quarter, partly the result of higher margins but also due to solid growth in average earning assets. Specifically, net interest income was up 13% to \$7,519,000 in the first quarter of 2018 from \$6,638,000 in the year-ago quarter, with margins expanding to 3.55% from 3.42% over the same respective period. As is discussed on the next page, North State has done an excellent job

ASSETS: \$878 MM

HQ: RALEIGH, NC

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1ST QUARTER HIGHLIGHTS:

EARNINGS GROWTH WAS EXCELLENT, WITH STRONG SHOWINGS IN NET INTEREST INCOME AND NONINTEREST INCOME

EPS: \$0.37 vs. \$0.33

EARNINGS BEFORE THE PROVISION INCREASED 36%

NET INTEREST INCOME GREW 13%

NONINTEREST INCOME WAS UP 7%

ALTHOUGH MORTGAGE INCOME WAS DOWN, THAT WAS MORE THAN OFFSET BY STRONG SBA INCOME

NORTH STATE HAS BEEN PROACTIVE IN RESPONDING TO THE MORTGAGE SLOWDOWN, THE RESULT BEING THAT PERSONNEL EXPENSES HAVE DROPPED OVER THE PAST YEAR

BALANCE SHEET GROWTH HAS BEEN COMMENDABLE

NONINTEREST BEARING DEPOSITS WERE THE FASTEST GROWING AREA OF DEPOSITS

NORTH STATE'S HIGHER THAN AVERAGE PERCENTAGE OF NONINTEREST BEARING DEPOSITS EFFECTIVELY LOWERS ITS COST OF FUNDS

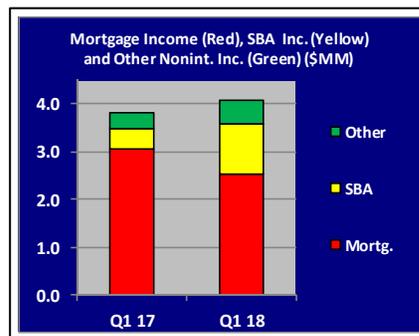
ASSET QUALITY CONTINUES TO IMPROVE

NPAs/ASSETS: 0.12%

RESERVES/LOANS: 0.63%

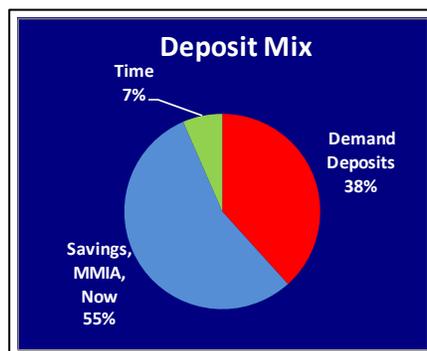
**EPS:
2016A: \$ 1.80
2017A: \$ 1.60
2018E: \$ 1.88**

building its core deposits by targeting its customers, one result being lower funding costs. Another encouraging area was noninterest income, which grew 7% to \$4,093,000 in 2018's first quarter from \$3,834,000 in the year-ago quarter. As can be seen from the adjacent chart, mortgage related income was soft, dropping roughly \$500,000. However, this softness (which is being felt nationally) was more than offset by strength in the SBA operation, which picked up more than \$600,000. Moreover, management indicates that the SBA pipeline continues to look strong, thanks in part to a growing staff of 15 processors and business development officers. As we have stated previously, achieving diversity in noninterest income is especially important when there are highly variable business lines, such as the mortgage business. Management has been very proactive in responding to the mortgage slowdown, closing several offices and reducing mortgage full time equivalents ("FTEs") by almost 20%. This action helped to contain costs, as noninterest expense increased a relatively modest 6% to \$9,227,000 in the first quarter of 2018 from \$8,720,000 in the year-ago quarter, with personnel expense actually dropping slightly over that period.



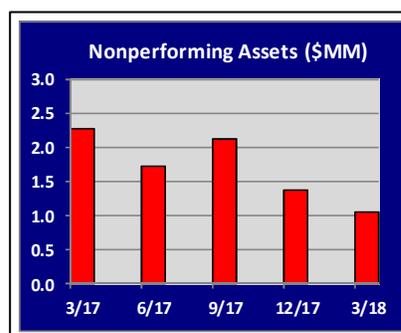
Balance Sheet Growth Was Good; Deposit Mix Is Highly Attractive

Balance sheet growth was commendable as well. From March 31, 2017 to March 31, 2018, loans held for investment grew 5%, while assets and deposits were up 7%. Within deposits, the most rapid growth was in demand deposits (typically the least expensive source of deposits for a bank), which grew 11%. In fact, North State has a much higher percentage of its deposits in demand deposits than the typical North Carolina bank. Whereas it has 38% of its deposits in noninterest bearing demand deposits, the median percentage for NC community banks is about 22% - 24%. This has favorable implications for North State's cost of funds, not to mention that these deposits tend to be more stable. The Bank has achieved this higher concentration of demand deposits by targeting specific customers, such as community and homeowner associations, dentists, doctors and nonprofits, among others.



Asset Quality is Excellent

As of March 31, 2018, total nonperforming assets were \$1.0 million, or 0.12% of assets, versus \$1.4 million, or 0.16% of assets, at December 31, 2017 and \$2.4 million, or 0.29% of total assets, at March 31, 2017. This level of NPAs (and the ratio of NPAs to assets) has not been this low in more than a decade. The allowance for loan losses was \$4.2 million, or 0.63% of total loans, at March 31, 2018, compared to \$4.3 million, or 0.68% of total loans, at the year-ago date.



Projections Maintained

We are retaining our 2018 earnings estimate at \$10.8 million, or \$1.88 per diluted share. Should loan growth pick up more than we expect, a higher provision could lower these projections. Also, given that North State derives a large portion of its revenues from the mortgage and SBA operations, actual results may vary significantly from these figures.

ADDITIONAL INFORMATION UPON REQUEST

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