

## North State Bancorp (Not Publicly Traded)

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**August 29, 2018**

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North Carolina  
27609

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<b>Price: *</b>	\$13.00	<b>EPS **</b>	<b>2016A:</b>	\$1.80	<b>P/E</b>	<b>2016A:</b>	NA
<b>52 Wk. Range:</b>	N/A	(FY: DEC)	<b>2017A:</b>	\$1.60		<b>2017A:</b>	NA
<b>Distributions (Estimated):</b>	\$1.32		<b>2018E:</b>	\$ 1.88		<b>2018E:</b>	NA
<b>Shares:</b>	5.8 mm	<b>Book Value: ***</b>		\$7.47	<b>Price/Book Value:</b>		NA

\* Stock is not actively traded. Last known trade. \*\* Earnings per share are diluted. \*\*\* Tangible book value is \$7.21 per share.

### Background

North State Bancorp (the “Company”) is a single bank holding company headquartered in Raleigh, North Carolina with approximately \$880 million in assets as of June 30, 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; 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.

### The Second Quarter Was Another Excellent Quarter for North State Bancorp

North State Bancorp reported solid results in the second quarter of 2018. Although reported earnings were essentially flat with the year-ago figures, there was a fairly large provision for loan losses in 2018’s second quarter, versus none in the year-ago quarter, the absence of which would have led to a nice increase in earnings. Moreover, the higher provision was the result of the Bank’s strong loan growth, which was another encouraging aspect of the quarter. The numbers “behind” the earnings were encouraging as well, as net interest income was strong and the strength in SBA income helped to offset some ongoing weakness in the mortgage area. To combat this mortgage slowdown (which has been happening nationally), the Company recently promoted one of its loan executives to Chief Mortgage Sales Officer to better coordinate its activities in this important sector. Finally, asset quality was excellent, with the NPAs-to-assets ratio well below the year-ago level.

In terms of specific results, net income for the second quarter of 2018 was \$2,881,000, or \$0.49 per diluted share, versus \$2,827,000, or \$0.49 per diluted share, in the year-ago quarter. Excluding the provision for loan losses, earnings increased 13% to \$3,191,000 in 2018’s second quarter, versus \$2,827,000 in the year-ago quarter. The underlying strength in earnings came principally from the growth in net interest income, which increased 17% to \$7,969,000 in the second quarter of 2018 from

**ASSETS: \$880 MM**

**HQ: RALEIGH, NC**

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#### 2<sup>ND</sup> QUARTER HIGHLIGHTS:

**EARNINGS PROGRESS WAS  
ACTUALLY BETTER THAN  
IMPLIED BY THE BOTTOM LINE  
DUE TO A HIGHER PROVISION**

**EPS: \$0.49 vs. \$0.49**

**EARNINGS BEFORE THE  
PROVISION INCREASED 13%**

**NET INTEREST INCOME WAS  
STRONG, INCREASING 17%**

**NONINTEREST INCOME WAS DOWN 14%, ALTHOUGH ALL OF THAT WAS DUE TO A DROP IN THE MORTGAGE BUSINESS**

**SBA INCOME HAS BEEN A STRONG AND CONSISTENT CONTRIBUTOR TO EARNINGS**

**NONINTEREST EXPENSE WAS ESSENTIALLY FLAT, DESPITE 8% ASSET GROWTH**

**ROAE: 27.6%**

**ROAA: 1.36%**

**FIRST HALF HIGHLIGHTS:**

**EPS: \$0.86 vs. \$0.82**

**THE INCREASED EARNINGS OCCURRED DESPITE AN INCREASE IN THE PROVISION**

**LOANS INCREASED 10% OVER THE PAST YEAR**

**MUCH OF LOAN GROWTH HAS BEEN FUNDED FROM LOWER YIELDING INVESTMENTS**

**ASSET QUALITY REMAINS QUITE GOOD**

**NPAs/ASSETS: 0.13%**

**RESERVES/LOANS: 0.63%**

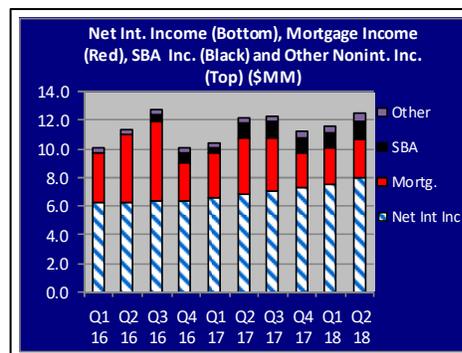
**EPS:**

**2016A: \$ 1.80**

**2017A: \$ 1.60**

**2018E: \$ 1.88**

\$6,839,000 in the year-ago quarter, with the net interest margin expanding to 3.50% from 3.41%, and average earning assets up about 5%. Tightly controlled funding costs contributed to this margin improvement. Noninterest income declined 14%, though all of that was due to the previously mentioned slowdown in the mortgage area. The mortgage drop can be seen by the contraction in the red bar in the figure to the right. One point that is worth noting, however, is that the Company has essentially replaced the mortgage revenue shortfall over the past year or two through higher net interest income and SBA income, the net effect being that total revenues in 2018's second quarter were within a few percentage points of being at an all-time high. We also consider it noteworthy that North State is achieving consistent income from its SBA activities, something many banks have had difficulty accomplishing. Expense containment was excellent also. Management has closed several mortgage production offices and reduced mortgage full time equivalents ("FTEs") over the past year, which has helped keep noninterest expense flat, despite the 8% growth in assets over the period. Annualized ROAE was quite high at 27.6% in 2018's second quarter, roughly unchanged from the year-ago level, while annualized ROAA was 1.36%, versus 1.22% in the year-ago quarter.



### First Half Earnings Were Up 6%, or 22% Before the Provision

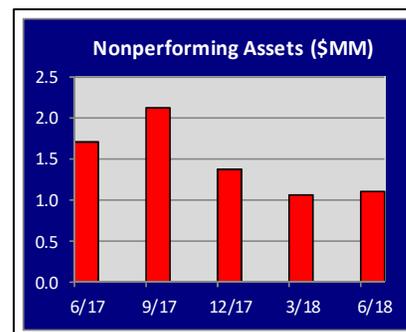
As was the case with the quarterly results, North State Bancorp's first half earnings progress was obscured by a higher provision for loan losses. While the Company reported net income of \$5,016,000, or \$0.86 per diluted share, up 6% from \$4,725,000, or \$0.82 per diluted share, in the year-ago period, net income before the provision was actually up 22%. Net interest income increased 15% and more than offset a 5% drop in noninterest income, while noninterest expense grew a modest 3% from the first half of 2017. The provision for loan losses was \$560,000 in the first half of 2018, versus a credit to the provision of \$146,000 in the year-ago period.

### Balance Sheet Growth Remains Excellent

North State continues to make excellent headway in terms of balance sheet growth. From June 30, 2017 to June 30, 2018, loans held for investment grew 10%, while assets and deposits were up 4%. A good deal of the loan growth over the past year has been funded through the sale of lower yielding investments, which has helped to sustain margins. Stockholders' equity has also grown rapidly, thanks to the Company's high ROAE. As of June 30, 2018, shareholders' equity was \$43.8 million, or 4.98% of assets, up from \$40.1 million, or 4.73% of assets, at the year-ago date.

### Asset Quality is Excellent

As of June 30, 2018, total nonperforming assets were \$1.1 million, or 0.13% of assets, versus \$1.0 million, or 0.12% of assets, at March 31, 2018 and \$1.8 million, or 0.22% of total assets, at June 30, 2017. This level of NPAs remains close to a ten-year low. The allowance for loan losses was \$4.4 million, or 0.63% of total loans, at June 30, 2018, compared to \$4.4 million, or 0.68% of total loans, at the year-ago date.



### Projections Maintained

We are retaining our 2018 earnings estimate at roughly \$11.0 million, or \$1.88 per diluted share. 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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