

North State Bancorp (Not Publicly Traded)

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ASSETS: \$1.3 BB

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3RD QUARTER HIGHLIGHTS:

EPS WERE \$0.23 ABOVE
PROJECTIONS

EPS: \$0.59 vs. \$0.51

THE PROVISION FOR LOAN
LOSSES DECREASED TO
\$250,000 IN Q3 21 FROM
\$2,070,000 IN Q3 20, THANKS
TO THE STRONG RESERVE
POSITION AND EXCELLENT
ASSET QUALITY

NET INTEREST INCOME GREW
7%, ALL OF WHICH WAS DUE TO
AVERAGE EARNING ASSET
GROWTH

NONINTEREST INCOME WAS
LOWER, REFLECTING A
SLOWDOWN IN THE MORTGAGE
AREA AND THE DECISION TO
RETAIN SOME OF THE BANK'S
SBA LOANS

SERVICE CHARGE INCOME
INCREASED 62% FROM THE
YEAR-AGO QUARTER

Price: *	\$16.00	EPS *	2020A:	\$2.53	P/E	2020A:	6.3x
52 Wk. Range:	N/A	(FY: DEC)	2021E:	\$2.64		2021E:	6.1x
Distributions (Estimated):	\$1.87		2022E:	NA		2022E:	NA
Shares:	6.1 mm	Book Value:		\$10.58	Price/Book Value:		1.51x

* Stock is not actively traded. Last known trade. Tangible book value is \$10.23. 2022 estimated EPS will be provided in a later report.

Background

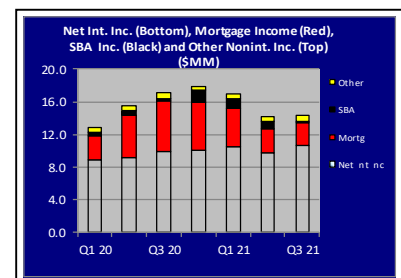
North State Bancorp (the "Company") is a single bank holding company headquartered in Raleigh, North Carolina with approximately \$1.3 billion in assets as of September 30, 2021. Its bank subsidiary is North State Bank, a commercial bank that began operations on June 1, 2000. North State Bancorp serves 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 Earnings Benefited from Lower Provision and Expense Control

North State Bank had another solid quarter in the three months ended September 30, 2021. Despite a significant slowdown in mortgage-related income, earnings were up sharply, thanks in part to lower expenses and a large drop in the provision for loan losses. (As we have stated before, sound loan underwriting pays dividends in many ways, not the least of which is that it puts less pressure on the loan loss provision. This has been one of North State's hallmarks throughout its 20-year history). Based on the strength of the earnings, we are increasing our earnings projections for the year. From a balance sheet standpoint, there was a contraction (as expected) in loans, reflecting PPP paydowns/forgiveness, although solid growth occurred in assets, deposits and shareholders' equity. Finally, we would note that key profitability measures remained quite strong.

Net income was \$3,602,000, or \$0.59 per share, in the third quarter of 2021, up 16% from \$3,107,000, or \$0.51 per share, in the year-ago quarter. Net interest income grew 7% to \$10,566,000 (including \$1,172,000 in the accretion of deferred PPP loan fees) in 2021's third quarter from \$9,914,000 (including \$925,000 in the accretion of deferred PPP loan fees) in the year-ago quarter. Net interest income excluding accretion was up about 5%. The net interest income growth was entirely due to higher volume, as the net interest margin was slightly lower at 3.28% in the third quarter of 2021, versus 3.33% in the year-ago quarter (average earning assets increased 6%). Adding to the earnings benefit from net interest income growth was the previously mentioned drop in the provision for loan losses, which was \$250,000 in the third quarter of 2021, versus \$2,070,000 in the third quarter of 2020.

Noninterest income was down from the year-ago quarter, partly due to mortgage income returning to a more normalized level after surging throughout much of 2020, as can be seen by the red bar in the adjacent chart. The decline was also due to the Bank holding on to some of its SBA loans (instead of selling them at gains) in order to bolster its earning asset yields. In other words, the Bank has some embedded SBA earnings that are likely to be realized in future periods. In total, noninterest income was \$3,692,000 in 2021's third quarter, compared to \$7,142,000 in the year-ago quarter. One bright spot in this area was service charge income, which was up 62% from the year-ago level.



EXPENSE CONTROL WAS EXCELLENT, AS NONINTEREST EXPENSE DROPPED 12%

NONINTEREST EXPENSE/AVERAGE ASSETS (ANNUALIZED) DECREASED TO 3.11% FROM 3.82%

YEAR-TO-DATE 2021 HIGHLIGHTS:

EPS: \$2.26 vs. \$1.47

WHILE LOANS CONTRACTED (AS EXPECTED), DEPOSIT, ASSET AND EQUITY GROWTH REMAINED SOLID

CORE DEPOSITS INCREASED 17%

NPAs DECREASED 33% FROM 6/30/21 AND 52% FROM THE YEAR-AGO DATE

NPAs/ASSETS: 0.18% vs. 0.23% FOR THE NC PEER GROUP MEDIAN

RESERVES/LOANS: 0.79%

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

Finally, we would note that North State did an excellent job containing its expenses during the third quarter of 2021. Specifically, noninterest expense was \$10,406,000 in 2021's third quarter, down 12% from \$11,879,000 in the year-ago quarter. The two largest components of noninterest expense, salaries and employee benefits and data processing and other outsourced services, declined 14% (combined) over this period, and most other expense categories also showed decreases, meaning the cost reductions were broad based. Noninterest expense as a percentage of average assets (annualized) was 3.11% in the third quarter of 2021, down from 3.82% in the third quarter of 2020. As was stated earlier, the Company's key profitability ratios were quite high, as seen in the above table.

	2020	2021
ROAA*	1.00	1.08
ROAE *	22.28	22.26
Net Int. Margin	3.33	3.28

* Based on S-Corp (untaxed) earnings

Year-to-Date Earnings Were Up 57%

Earnings for the first nine months of 2021 were likewise quite impressive and benefitted from a much lower provision. Net income was \$13,869,000, or \$2.26 per share, up 57% from \$8,847,000, or \$1.47 per share, in the year ago period. Net interest income increased 10%, noninterest income was down 17% (mainly reflecting lower fees from mortgage operations) and noninterest expenses declined 5% compared to the first nine months of 2020. The provision for loan losses was \$360,000 in 2021's first nine months, versus \$3,940,000 in the first nine months of 2020. As we had anticipated, the balance sheet moderated in the loan area, though deposit growth remained strong, particularly for core deposits. Specifically, from September 30, 2020 to September 30, 2021, net loans were down 6%, total assets increased 7% and total deposits were up 17%. Much of this deposit growth was in core deposits, which exclude internet, CDARs, brokered CDs and CDs over \$100,000. Thanks largely to the Company's high return on equity, shareholders' equity totaled \$64.8 million, or 4.89% of total assets, as of September 30, 2021, a significant increase from \$53.8 million, or 4.33% of total assets, as of September 30, 2020.

Delinquent Loans Continued to Decrease, Asset Quality Compares Favorably to NC Peers

Nonperforming assets remain in a downward trajectory. Moreover, the key asset quality metrics are better than the majority of the Company's North Carolina peers. Total nonperforming assets ("NPAs", excluding restructured loans) were \$2.4 million, or 0.18% of total assets, as of September 30, 2021, which was down 33% from \$3.5 million, or 0.27% of total assets, as of June 30, 2021, and down 52% from \$4.9 million, or 0.41% of total assets, as of the year-ago date. The allowance for loan losses totaled \$7.1 million, or 0.79% of total loans, as of September 30, 2021, compared to \$8.4 million, or 0.88% of total loans, as of the year-ago date (the lower allowance for loan losses is a reflection of increased recoveries, improving asset quality and industry wide expectations of lower loan loss exposure).

	North State 9/30/20	North State 9/30/21	NC Peer Group Median
NPAs/Assets (%)	0.41	0.18	0.23
Reserves/NPAs (x)	1.67	2.99	2.40
Reserves/Loans (%)	0.88	0.79	1.05

Projections Increased

We are increasing our 2021 earnings projections to \$16.2 million, or \$2.64 per share, up from \$2.30 estimated previously. We are deferring the publication of our 2022 EPS estimate given current economic uncertainties, but intend to release them in one of our next reports. Actual earnings could vary substantially from these projections given the economic uncertainties.

ADDITIONAL INFORMATION UPON REQUEST

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