

North State Bancorp (Not Publicly Traded)

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Raleigh
North Carolina
27609

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Price: *	\$16.00	EPS **	2018A:	\$1.65	P/E	2018A:	9.7x
52 Wk. Range:	N/A	(FY: DEC)	2019A:	\$1.95		2019A:	8.2x
Distributions (Estimated):	\$1.32		2020E:	\$1.88		2020E:	8.5x
Shares:	6.0 mm	Book Value:		\$8.49	Price/Book Value:		1.88x

* Stock is not actively traded. Last known trade. ** Earnings per share are diluted.

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Background

North State Bancorp (the “Company”) is a single bank holding company headquartered in Raleigh, North Carolina with approximately \$934 million in assets as of December 31, 2019. 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, 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.) Finally, in 2018, the Company created a lease financing group. The Company is an S-Corporation for tax purposes.

Fourth Quarter Earnings Grew 69%, EPS Exceeded Estimates By \$0.08 Per Share

North State Bancorp reported excellent results for the fourth quarter of 2019 which exceeded our projections. Revenue growth was strong, particularly in noninterest income, and cost containment also contributed to the strong earnings performance. There was no provision for loan losses in 2019’s fourth quarter, versus a provision of \$200,000 in the year-ago quarter, though earnings growth even excluding the provision were excellent, increasing 52% from the fourth quarter of 2018. Balance sheet growth was in the single digits percentage wise, as we had expected, and profitability levels were exemplary. Finally, while nonperforming assets increased at December 31, 2019, North State’s asset quality remains better than the majority of its North Carolina peers. All in all, it was another excellent quarter and year.

Reported net income for the fourth quarter of 2019 was \$3,025,000, or \$0.50 per diluted share, which was up 69% from \$1,785,000, or \$0.30 per diluted share, in the year-ago quarter. We had estimated the Company would have EPS of \$0.43, so actual results were \$0.08 per share above estimates. The level of earnings resulted in impressive profitability metrics, as annualized return on average equity (“ROAE”) was approximately 23.6% and return on average assets (“ROAA”) was about 1.24% (see further discussion of these metrics on the next page). Net interest income increased 5% to \$9,025,000

ASSETS: \$934 MM

HQ: RALEIGH, NC

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4TH QUARTER HIGHLIGHTS:

FOURTH QUARTER AND FULL
YEAR EARNINGS WERE STRONG

EPS WERE \$0.07 ABOVE
ESTIMATES

EPS: \$0.50 vs. \$0.30

NET INTEREST INCOME GREW
5%

NONINTEREST INCOME WAS UP 13%

NONINTEREST EXPENSE DECREASED 3% FROM THE YEAR-AGO QUARTER

YEAR 2019 HIGHLIGHTS:

EPS: \$1.95 vs. \$1.65

NET INTEREST INCOME WAS UP 11% AND MORE THAN OFFSET A DECLINE IN NONINTEREST INCOME

NONINTEREST EXPENSE DECLINED 1%

ROAE: 23.61%

MOST BALANCE SHEET FIGURES GREW ABOUT 4% OVER THE PAST YEAR

EQUITY/ASSETS: 5.46%

NPAS/ASSETS: 0.11%, WHICH WAS MUCH BETTER THAN 0.36% FOR THE NC PEER GROUP MEDIAN

RESERVES/LOANS: 0.64%

**EPS:
2018A: \$ 1.65
2019A: \$ 1.95
2020E: \$ 1.88**

in 2019's fourth quarter, compared to \$8,594,000 in the year-ago quarter. Noninterest income growth was even better, growing 13% to \$2,890,000 in the fourth quarter of 2019 from \$2,552,000 in the year-ago quarter, due mainly to higher fees from mortgage operations (fees from mortgage operations were \$1,629,000 in 2019's fourth quarter, versus \$1,070,000 in the year-ago quarter). As mentioned earlier, earnings also benefited from a decline in noninterest expense, which totaled \$8,891,000 in 2019's fourth quarter, down 3% from \$9,161,000 in the year-ago quarter, and down 9% from \$9,764,000 in the third quarter of 2019.

Net Income for the Year 2019 Increased 20%

North State likewise reported strong earnings growth for the year 2019, with net interest income showing robust growth and expenses actually contracting. Specifically, net income was \$11,606,000, or \$1.95 per diluted share, for 2019, which was up 20% from \$9,659,000, or \$1.65 per diluted share, for 2018. Double-digit growth in net interest income of 11% from the year 2018 to 2019 more than offset a 15% decline in noninterest income, which reflected lower fees from mortgage operations and sales from SBA operations. As was stated above, lower expenses also contributed to earnings growth, as noninterest expense was down 1% from 2018 to 2019. The provision for loan losses totaled \$680,000 for 2019, versus \$700,000 in 2018. The strong yearly performance is evident in its key return ratios, all of which improved from 2018 and were better than the NC peer median. (ROAE and ROAA were shown for peers on a pretax basis to be "apples to apples.")

PROFITABILITY AND EFFICIENCY RATIOS (% ANNUALIZED)			
	2018	2019	NC Peer Group Median
ROAA*	1.10	1.24	1.14
ROAE *	21.43	23.61	10.93
Net Int. Margin	3.91	4.07	3.72

** Pretax for peer group.*

Balance Sheet Growth Is Likely to Remain Fairly Controlled

From December 31, 2018 to December 31, 2019, total assets, net loans and deposits all increased 4%. Maintaining a modest growth rate puts the Bank in an excellent position to be highly selective about which loans to accept and puts less pressure on the Bank to generate deposit growth. Shareholders' equity was \$51.0 million, or 5.46% of total assets, at December 31, 2019. At December 31, 2019, the leverage ratio was 8.91%, the tier one capital ratio was 11.04% and the total capital ratio was 11.69%, all of which exceeded the minimums for North State to be considered "well capitalized."

Asset Quality is Superior to Majority of NC Peers

North State Bancorp's nonperforming assets increased slightly at the end of the year 2019, but overall asset quality remains solid. Nonperforming assets ("NPAs") specifically totaled \$1,028,000, or 0.11% of total assets, at December 31, 2019, compared to \$654,000, or 0.07% of total assets, at September 30, 2019, and \$939,000, or 0.10% of total assets, at the year-ago date. Loans that were 30 to 89 days past due, which often are a leading indicator of NPA movement, totaled \$3.5 million at December 31, 2019, versus \$2.8 million at September 30, 2019 and \$2.1 million at the year-ago date. North State's asset quality ratios were superior to the Company's NC peer group, and the NPAs/assets ratio was in the top three best of the group of twelve. The allowance for loan losses was \$4.9 million, or 0.64% of total loans, at December 31, 2019, which was up 18% from \$4.2 million, or 0.56% of total loans, at the year-ago date.

Projections

We are projecting earnings for the year 2020 of \$11.3 million, or \$1.88 per diluted share. Actual results may obviously vary significantly from these figures based on varying credit and other conditions.

ADDITIONAL INFORMATION UPON REQUEST

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