

North State Bancorp (Not Publicly Traded)

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Price: *	\$11.90	EPS **	2016A:	\$1.80	P/E	2016A:	NA
52 Wk. Range:	N/A	(FY: DEC)	2017A:	\$1.60		2017A:	NA
Distributions (Estimated):	\$1.09		2018E:	\$ 1.88		2018E:	NA
Shares:	5.8 mm	Book Value: ***		\$7.18	Price/Book Value:		NA

* Stock is not actively traded. Last known value. ** Earnings per share are diluted. *** Tangible book value is \$6.99 per share.

Background

North State Bancorp (the “Company”) is a single bank holding company headquartered in Raleigh, North Carolina with approximately \$836 million in assets as of December 31, 2017. 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.

Fourth Quarter Operating Earnings Were Better Than Implied by the Bottom Line Figures

North State Bank reported commendable earnings in the fourth quarter of 2017. Although net income in 2017’s fourth quarter actually dropped from the year-ago level, all of that was due to a large recovery for loan losses in the year-ago quarter. Excluding the recoveries (there was one in both quarters), earnings would have increased significantly. It was also a good quarter from a revenue standpoint, as increases were posted in both net interest income and noninterest income relative to the year-ago quarter. And asset quality was excellent, with year-end nonperforming assets as a percentage of assets being at the lowest they have been in over 10 years. Finally, we would note that the Company paid out \$1.09 in distributions over the past year, exceeding management’s original estimate of trying to distribute about \$0.90 per share in its first year as an S-Corporation.

Net income for the fourth quarter of 2017 totaled \$1,698,000, or \$0.30 per diluted share, versus \$2,715,000, or \$0.47 per diluted share, in the year-ago quarter. Net income before the recovery for loan losses was \$1,398,000 in 2017’s fourth quarter, up 15% from \$1,214,000 in the year-ago quarter. As has been the case for the past several quarters, net interest income growth was excellent

	2016 Q4	2017 Q4
Quarterly Results (\$000s)		
Net Income	2,715	1,698
Eliminate Recovery for Loan Losses	(1,501)	(300)
Net Income Excl. Provision Effects	1,214	1,398

ASSETS: \$836 MM

HQ: RALEIGH, NC

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4TH QUARTER HIGHLIGHTS:

**EARNINGS COMPARISONS WERE
AFFECTED BY A LARGE
RECOVERY IN THE PROVISION
FOR LOAN LOSSES LAST YEAR**

EPS: \$0.30 vs. \$0.47

**EARNINGS BEFORE
RECOVERIES IN BOTH
QUARTERS ACTUALLY
INCREASED 15%**

NET INTEREST INCOME GREW 14%

NET INTEREST INCOME, A KEY DRIVER OF LONG-TERM EARNINGS, HAS BEEN STEADILY GROWING

NONINTEREST INCOME WAS UP 5%, THANKS IN PART TO STRONG SBA RESULTS

NONINTEREST EXPENSE WAS UP 9%, MAINLY DUE TO KEY PERSONNEL ADDITIONS

FULL YEAR HIGHLIGHTS:

EPS: \$1.60 vs. \$1.80

NET INTEREST INCOME INCREASED 10%

THE RATIO OF NPAs TO ASSETS ARE AT THE LOWEST LEVEL IN MORE THAN TEN YEARS

NPAs/ASSETS: 0.16%

RESERVES/LOANS: 0.60%

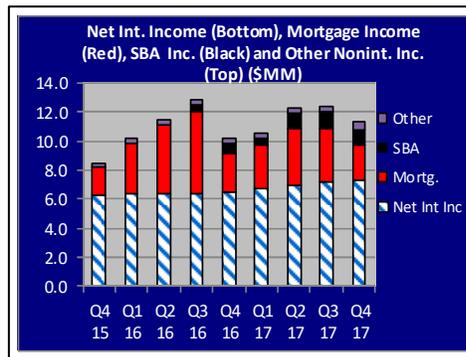
EPS PROJECTIONS

2016A: \$ 1.80

2017A: \$ 1.60

2018E: \$ 1.88

and was supported by higher margins and good average earning asset growth. Specifically, net interest income grew 14% to \$7,290,000 in the fourth quarter of 2017 from \$6,415,000 in the year-ago quarter. North State Bancorp has done an excellent job of lowering its funding costs over time, the benefits of which have been seen in a nice improvement in margins over time. Another area of strength was noninterest income. Total noninterest income was \$3,939,000 in 2017's fourth quarter, up 5% from \$3,751,000 in the year-ago quarter. As can be seen in the adjacent chart, noninterest income tends to vary a good bit throughout the year. Largely as a result of the mortgage area, the third quarter of the year is typically the strongest, followed by the second quarter, and then the first and fourth quarters. For this reason, earnings comparisons really need to be measured against year-ago periods as opposed to linked quarters. Another point we would make from the chart is the stability and consistent growth in net interest income, which is typically the "main engine" for most banks' earnings. The chart also shows the importance of diversity as to the sources of noninterest income, as recent weakness in mortgage area has been offset by strength in SBA income. As a final note on the quarterly results, noninterest expense increased 9% to \$9,831,000 in the fourth quarter of 2017 from \$9,005,000 in the year-ago quarter, mainly due to higher personnel expense.

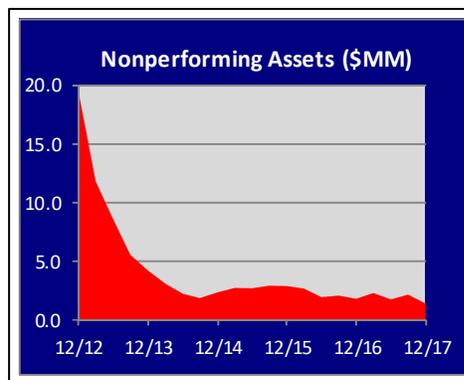


Full Year Operating Earnings Were Likewise Strong

Earnings for the full year of 2017 were also commendable. Net income was \$9,273,000, or \$1.60 per diluted share for 2017, as compared to \$10,229,000, or \$1.80 per diluted share, in 2016. As was the case with the quarterly results, the drop in income was due to a large recovery for loan losses in the year-ago period. Earnings before the recovery (as well as being before security gains in the year-ago period) were up 5%. Net interest income increased 10%, while noninterest income, excluding security gains, was down 6%. Noninterest expense growth was modest at 3%. Balance sheet growth was fairly stable over the past year. From December 31, 2016 to December 31, 2017, loans grew 7%, while assets and deposits were up 6%. Shareholders' equity was \$41.9 million, or 5.0% of assets at December 31, 2017.

Asset Quality is Excellent

North State Bancorp has continued to improve the quality of its loan portfolio. As of December 31, 2017, total nonperforming assets were \$1.4 million, or 0.16% of assets, versus \$2.1 million, or 0.25% of total assets, at September 30, 2017 and \$2.0 million, or 0.26% of total assets, at the year-ago date. The extent of improvement that has occurred in the past five years is quite noteworthy, as can be seen from the adjacent chart. In fact, the ratio of NPAs to assets has not been this low in more than 10 years. The allowance for loan losses was \$4.0 million, or 0.60% of total loans, at December 31, 2017, compared to \$4.3 million, or 0.70% of total loans, at the year-ago date.



Projections

Based on the most recent results, we expect 2018 earnings to increase to \$10.9 million, or \$1.88 per diluted share. Note that due to North State deriving a large portion of its revenues from the mortgage and SBA operations, actual results may vary significantly from these projections.

ADDITIONAL INFORMATION UPON REQUEST

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