

North State Bancorp (Not Publicly Traded)

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July 12, 2022

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Raleigh
North Carolina
27609

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Price: *	\$16.55	EPS *	2020A:	\$2.53	P/E	2020A:	6.5x
52 Wk. Range:	\$16.55 – 19.75	(FY: DEC)	2021A:	\$2.64		2021A:	6.3x
Distributions (Estimated):*	\$1.58		2022E:	\$2.25		2022E:	7.4x
Shares:	6.3 mm	Book Value:		\$10.70	Price/Book Value:		1.55x

* Stock is not actively traded. Last known trade. Tangible book value is \$10.34. Distributions are estimates based on 70% of EPS.

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ASSETS: \$1.5 BB

HQ: RALEIGH, NC

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2ND QUARTER HIGHLIGHTS:

EPS: \$0.51 vs. \$0.71

EARNINGS WERE AFFECTED BY THE DROP IN NET PPP FEES, AS WELL AS A HIGHER PROVISION

IGNORING THESE TWO ITEMS, EARNINGS WOULD HAVE INCREASED

EARNINGS WERE ALSO AFFECTED BY LOWER MORTGAGE FEE INCOME

NET INTEREST INCOME WAS UP 13%, DUE PRIMARILY TO AVERAGE EARNING ASSET GROWTH OF 14%, AS MARGINS WERE FLAT

NONINTEREST INCOME DECREASED 24%, DUE TO A DECLINE OF 56% IN MORTGAGE OPERATIONS FEES

Background

North State Bancorp (the “Company”) is a single bank holding company headquartered in Raleigh, North Carolina with approximately \$1.5 billion in assets as of June 30, 2022. 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.

Second Quarter Fundamentals Were Good

North State Bancorp reported better core earnings comparisons in the second quarter of 2022 than were apparent from the bottom-line results. In particular, the quarterly earnings comparisons to the year-ago quarter were affected by an increase in the provision for loan losses (reflecting excellent loan growth), as well as a sizable drop in net PPP fees from the payoff/forgiveness of PPP loans. Excluding those two items, earnings would have increased significantly, as is discussed further below. So, from a recurring, operating standpoint, earnings looked quite commendable. Moreover, balance sheet growth was strong, with most key areas increasing relative to year-ago figures in the 9% to 17% range (the deposit mix also improved). Given increasing concerns about inflation and a potentially slowing economy, we found this recent loan and deposit growth particularly encouraging. Finally, and importantly, asset quality remains excellent, as key asset quality metrics were impressive and NPAs were well below year-ago levels.

In terms of specific results, North State Bancorp reported net income of \$3,161,000, or \$0.51 per share, for the second quarter of 2022, versus \$4,330,000, or \$0.71 per share, in the year-ago quarter. As was stated above, much of the decline was due to a swing in the provision (an unfavorable \$750,000), as well as a drop in net PPP fees, which decreased to \$32,000 in 2022’s second quarter from \$856,000 in the year-ago quarter. As can be seen in the adjacent table, if we eliminate each of those two items, the “adjusted” earnings would have actually increased about 14% to \$3,329,000 in 2022’s second quarter from \$2,924,000 in the year ago quarter. Net interest income held up quite well, increasing 13% to \$11,018,000 in 2022’s second quarter compared to \$9,775,000 in the year-ago quarter. The vast majority of that increase was the result of growth in average earning assets (up 14%), as margins were essentially unchanged at roughly 3.17%. The Bank continues to experience some headwinds in the mortgage area, which led to total noninterest income being down 24% to \$3,331,000 in 2022’s second quarter, versus \$4,406,000 in the year-ago quarter. Importantly, though, all of the other major categories of noninterest income were either stable or considerably higher. Some of the notable increases were fees and gains from SBA operations, which were up 37% to \$1,355,000, service charges, which increased 71% to \$123,000 and other

	2021 Q2	2022 Q2
Quarterly Results (\$000s)		
Net Income	4,330	3,161
Adjustments:		
Provision (Add/Deduct Credits)	(550)	200
Net PPP Loan Fee Accretion	(856)	(32)
Net Inc. Bef. Prov. & PPP Fees	2,924	3,329

**NONINTEREST EXPENSE GREW A
MODEST 6%**

**THE ROAA, ROAE AND
EFFICIENCY RATIOS WERE
STRONG**

FIRST HALF HIGHLIGHTS:

EPS: \$0.97 vs. \$1.68

**NET INTEREST INCOME GREW
2%**

FROM 6/30/21 TO 6/30/22:

**NET LOANS INCREASED 10%,
DEPOSITS GREW 17% AND
TOTAL ASSETS WERE UP 16%**

**HIGHER COST CDS WERE DOWN
6%, WHILE "CORE" DEPOSITS
GREW 17%**

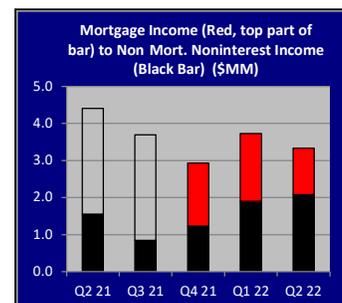
EQUITY/ASSETS: 4.51%

**NPAS/ASSETS: 0.15% vs. 0.27%
AT THE YEAR-AGO DATE**

RESERVES/LOANS: 0.70%

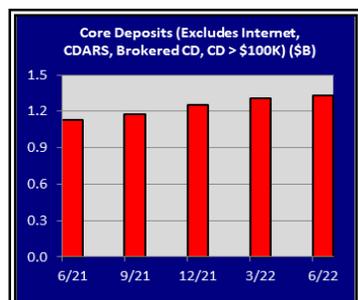
**EPS:
2020A: \$ 2.53
2021A: \$ 2.64
2022E: \$ 2.25**

noninterest income, which was up 32% to \$309,000. As can be seen in the adjacent chart, the sum of these non-mortgage sources of income (shown in black at the bottom) have continued to grow over the past several quarters, and were up from the year-ago level. The important point here is that North State has done an excellent job of building multiple income streams to support noninterest income. Finally, we would note that expense containment was good, as noninterest expense increased a modest 6% to \$10,988,000 in 2022's second quarter from \$10,401,000 in the year-ago quarter, primarily due to data processing and other outsourced services (up 20%). As a final quarterly comment, North State's efficiency and profitability metrics are impressive. The Company's ROAA was 0.87% in 2022's second quarter, while its ROAE was 19.2% and its efficiency ratio was 76.6%.



Results for the first half of 2022 were likewise impacted by the lower net PPP fees, and to a lesser degree, a higher provision (the provision was \$200,000 in 2022's first half, versus a year-ago level of \$110,000). Net income totaled \$6,028,000, or \$0.97 per share, compared to \$10,266,000, or \$1.68 per share, in the first half of 2021. Net PPP fees were \$173,000 in 2022's first half, a significant drop from \$2,117,000 in the year-ago period. The other major factor in the lower earnings was the drop in mortgage income, which was \$3,085,000 in 2022's first half, versus \$7,596,000 in the year-ago period. Net interest income increased 2%, noninterest income was down 35% and noninterest expense was up 3% over this period.

"Core" Deposits Increased 17% Over the Past Year



Balance sheet growth over the past year was excellent and was led by deposits. We would also note that the mix of deposits improved over this period. In terms of specifics, from June 30, 2021 to June 30, 2022, net loans grew 10%, deposits were up 17% and total assets increased 16%. In fact, net loans were actually up 5% (19% annualized) in the last three months. On the deposit side, higher cost certificates of deposit decreased 6% over this period, while core deposits (which exclude internet, CDARs, brokered CDs and CDs over \$100,000) were up 17% over the same period. Finally, shareholders' equity was \$67 million, or 4.5% of total assets, as of June 30, 2022. Equity growth has benefitted from the Company's unusually high ROAE, as well as a recently implemented capital reinvestment plan in which \$688,000 was raised from existing shareholders (71% participation rate) during the second quarter.

NPAs Decreased 36% from June 30, 2021

Asset quality remains excellent. North State's NPAs were \$2,258,000, or 0.15% of total assets, as of June 30, 2022, compared to \$1,900,000, or 0.13% of total assets, as of March 31, 2022, and \$3,530,000, or 0.27% of total assets, as of the year-ago date. The allowance for loan losses was \$7,025,000 (0.70% of total loans) as of March 31, 2022, versus \$7,019,000 (0.77% of total loans) as of the year-ago date.

Projections Increased

We are increasing our 2022 earnings estimate to \$14.0 million, or \$2.25 per share. We would also note that while these figures are down from 2021's earnings of \$16.2 million, 2022 projections only include \$173,000 in PPP fees, versus \$4.2 million in 2021, and mortgage income is expected to be lower as well. Actual earnings could vary substantially from these projections given the economic uncertainties.

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