

North State Bancorp (Not Publicly Traded)

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Raleigh
North Carolina
27609

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Price: *	\$19.75	EPS *	2020A:	\$2.53	P/E	2020A:	7.8x
52 Wk. Range:	N/A	(FY: DEC)	2021A:	\$2.64		2021A:	7.5x
Distributions (Actual):	\$2.02		2022E:	\$2.07		2022E:	9.5x
Shares:	6.2 mm	Book Value:		\$10.54	Price/Book Value:		1.87x

* Stock is not actively traded. Last known trade. Tangible book value is \$10.21.

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ASSETS: \$1.4 BB

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4TH QUARTER HIGHLIGHTS:

DESPITE A DROP IN EARNINGS, MANY OF NORTH STATE'S PROFITABILITY METRICS, SUCH AS ROAE, REMAINED GOOD

THERE WAS A LARGE (EXPECTED) DROP IN MORTGAGE AND SBA RELATED INCOME IN 2021'S FOURTH QUARTER, AS WELL AS NONRECURRING EXPENSES RELATED TO THE WRITE-OFF OF ASSETS

EPS: \$0.37 vs. \$1.06

NET INTEREST INCOME GREW 1%

Background

North State Bancorp (the "Company") is a single bank holding company headquartered in Raleigh, North Carolina with approximately \$1.4 billion in assets as of December 31, 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.

Fourth Quarter Earnings Affected By Several Nonrecurring Items

Even though North State Bancorp reported lower fourth quarter earnings, we viewed the results as being commendable given the presence of a number of nonrecurring expenses and the slowdown (which was anticipated) in mortgage income. Even with the lower earnings in 2021's fourth quarter, the Company continued to achieve some impressive performance metrics, as evidenced by its annualized ROAE of 14.1% in 2021's fourth quarter. The Company's ability to earn a high ROAE reflects a number of key success factors at the Bank, such as its low-cost structure, a creative and inexpensive funding strategy ("CommunityPlus") and the building of highly scalable and lucrative noninterest income sources, such as SBA income and mortgage banking. From an investor's standpoint, achieving a high ROAE is one of the most critical metrics that drives long-term performance. It was also a good quarter in that balance sheet growth was solid, with liquidity particularly strong, and asset quality continued to improve.

In terms of specifics, North State reported net income of \$2,286,000, or \$0.37 per share, for the fourth quarter of 2021, compared to \$6,400,000, or \$1.06 per share, in the year-ago quarter. The biggest single driver of the decline in earnings was the lower mortgage income, reflecting the "rush to refinance" in the year-ago quarter, the incremental increases in rates in 2021 and the ongoing appreciation in home prices. Between the lower mortgage income and the Company's decision (a good one in our view) to hold on to some of its SBA loans (as opposed to selling them at gains), the income from mortgages and SBA declined more than \$5.2 million to \$2,178,000 in 2021's fourth quarter from a year-ago level of \$7,411,000. In addition to this drop, there was roughly \$585,000 in nonrecurring expenses relating to the demolition and write-off of assets for a West Raleigh office, where the Bank will be opening a new location in about 18 months. So bottom line, the drop in earnings was not unexpected and was mainly due to nonrecurring items and income sources that tend to be highly variable.

In terms of the some of the core earnings drivers, net interest income totaled \$10,119,000 in 2021's fourth quarter, up slightly from \$9,977,000 in the year-ago quarter. The net interest margin remained under pressure (it was 3.07% in 2021's fourth quarter, versus 3.41% in the year-ago quarter), primarily reflecting a change in the mix of earning assets stemming from a lower base of higher earning loans and a higher base of lower earning cash and cash equivalents in 2021's fourth quarter compared to the

YEAR-OVER-YEAR, AVERAGE EARNING ASSETS GREW 20%

NONINTEREST INCOME WAS DOWN DUE TO THE DECLINE IN THE MORTGAGE AND SBA AREAS

NONINTEREST EXPENSE WAS UP BUT MUCH OF THIS WAS DUE TO NONRECURRING ITEMS

FULL YEAR 2021 HIGHLIGHTS:

EARNINGS GREW 6%

EPS: \$2.64 VS. \$2.53

NET INTEREST INCOME WAS UP 8%

FROM 12/31/20 TO 12/31/21:

NET LOANS DECLINED 4%, DEPOSITS INCREASED 20% AND TOTAL ASSETS WERE UP 19%

EQUITY/ASSETS: 4.67%

NPAS DECREASED FROM BOTH 9/30/21 AND 12/31/20

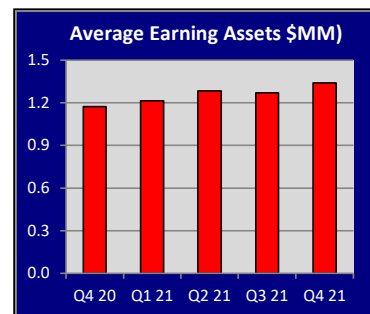
NPAS WERE ENTIRELY NONACCRUAL LOANS

NPAS/ASSETS: 0.16% VS. 0.31% AT THE YEAR-AGO DATE MEDIAN

RESERVES/LOANS: 0.73%

EPS:
2020A: \$ 2.53
2021A: \$ 2.64
2022E: \$ 2.07

year-ago quarter. Growth in average earning assets (20%) more than offset this margin impact. PPP fee accretion that was recognized in 2021's fourth quarter was \$870,000, down from \$1,176,000 in the year-ago quarter. One bright spot of the quarter was the provision for loan losses, which was actually a release of loan losses of \$360,000 in 2021's fourth quarter, compared to a provision of \$1,100,000 in 2020's fourth quarter. Finally, we would note that noninterest expense, which included the aforementioned one-time nonrecurring costs, increased 13% to \$11,124,000 in the fourth quarter of 2021 from \$9,866,000 in the year-ago quarter.

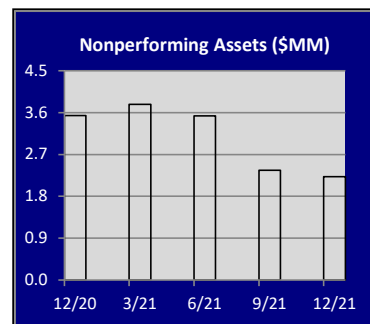


Results for the full year 2021 were likewise affected by highly varying mortgage and SBA income, as well as nonrecurring expenses. Net income for the twelve months ended December 31, 2021 totaled \$16,155,000, or \$2.64 per share, which was up 6% from \$15,248,000, or \$2.53 per share, in the year-ago period. There was no provision for loan losses in the year 2021, versus a provision of \$5,040,000 in the year 2020. Net interest income increased 8%, noninterest income was down 30% and noninterest expense declined about 1% over this period. In terms of PPP fee accretion, \$4,159,000 was recognized in 2021, as compared to \$2,685,000 in 2020. Fees from mortgage operations totaled \$12,152,000 in 2021, versus \$20,413,000 in 2020.

Balance sheet growth over the past year was led by deposits and assets, with the increase in cash and investments especially strong. (Net loans were down, as expected, reflecting PPP loan payoffs/forgiveness.) Specifically, from December 31, 2020 to December 31, 2021, net loans were down 4%, deposits increased 20%, total assets grew 19% and cash and securities were up 191%. Encouragingly, of the total deposit growth, core deposits (which exclude internet, CDARs, brokered CDs and CDs over \$100,000) increased 22%. Shareholders' equity as of December 31, 2021 was \$65.2 million, or 4.67% of total assets.

NPAs Decreased 39% from the Year-Ago Date

North State's asset quality continued to improve at the end of 2021, as displayed in the adjacent chart. Total nonperforming assets ("NPAs", excluding restructured loans) were \$2.2 million, or 0.16% of total assets, at December 31, 2021, down from \$2.4 million, or 0.18% of total assets, as of September 30, 2021, and \$3.6 million, or 0.31% of total assets, at the year-ago date. NPAs at December 31, 2021 were entirely comprised of nonaccrual loans. Reserve coverage improved, with the allowance for loan losses increasing to \$6.7 million (0.73% of total loans) at the end of 2021, up from \$6.5 million (0.68% of total loans) as of the year-ago date. Not surprisingly, North State's asset quality was better compared to the majority of its NC peers. Its NPAs/assets ratio of 0.16% was half that of the peer group and its reserve/NPAs ratio also was also much better.



Projections

We are estimating North State Bancorp will earn \$12.9 million, or \$2.07 per share for the year 2022. While this is down from 2021's earnings of \$16.2 million, 2022 projections only include roughly \$173,000 in expected 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.

ADDITIONAL INFORMATION UPON REQUEST

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