



NORTH STATE BANCORP

2021 Annual Report

General Corporate Information

ANNUAL MEETING

The annual meeting of shareholders of North State Bancorp will be held on Wednesday, June 8, 2022, at 4:00 p.m. at Raleigh Country Club, 400 Donald Ross Drive, Raleigh, North Carolina 27610. All shareholders are invited to attend and will be able to vote their shares in person, however we strongly encourage you to vote your shares prior to the meeting by sending your proxy card to us in the provided business reply envelope or by scanning and emailing the proxy card to us at ProxyVote@NorthStateBank.com.

MARKET FOR COMMON EQUITY AND RELATED SHAREHOLDER MATTERS

As of December 31, 2021, we had 6,095,594 shares of common stock outstanding, which were held by approximately 180 beneficial owners. As an S Corporation, North State Bancorp trades shares of its common stock across the Company's desk and they are not available on any exchange.

INDEPENDENT AUDITORS

Dixon Hughes Goodman LLP
2501 Blue Ridge Road, Suite 500
Raleigh, NC 27607

REGULATORY AND SECURITIES COUNSEL

Wyrick Robbins Yates & Ponton LLP
4101 Lake Boone Trail, Suite 300
Raleigh, NC 27607

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

A copy of North State Bancorp's Audited Consolidated Financial Statements as of and for the years ended December 31, 2021, and 2020 is available without charge to shareholders upon written request to Stacy R. Reedy, Executive Vice President and Chief Financial Officer, North State Bancorp, P.O. Box 18367, Raleigh, NC 27619, and is on our website at NorthStateBank.com.

This Annual Report and the above referenced Audited Consolidated Financial Statements have not been reviewed or confirmed for accuracy or relevance by the FDIC or any other governmental agency.

Banking and Mortgage Offices

CORPORATE HEADQUARTERS & NORTH RALEIGH BANKING OFFICE

6204 Falls of Neuse Road
Raleigh, NC 27609
919.855.9925

OPERATIONS CENTER

6200 Falls of Neuse Road
Raleigh, NC 27609

GARNER

835 Highway 70 West
Garner, NC 27529

DOWNTOWN RALEIGH

230 Fayetteville Street
Suite 100
Raleigh, NC 27601

NORTH HILLS

4270 The Circle at North Hills
Raleigh, NC 27609

SOUTHEAST RALEIGH MORTGAGE

1708 Trawick Road
Suite 209
Raleigh, NC 27604

WAKE FOREST

14091 Falls of Neuse Road
Raleigh, NC 27614

WEST RALEIGH

2413 Blue Ridge Road
Raleigh, NC 27607

WILMINGTON

1411 Commonwealth Drive
Wilmington, NC 28403

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***We simply live better
when we are connected.***

To our Shareholders, Customers, and Friends:

On behalf of all of us at North State Bank, I'm pleased to report that the health of our Company, as indicated by our financial results, is very strong. Total assets, loans, and deposits for North State Bancorp (the "Company") as of December 31, 2021, were \$1.40 billion, \$918.0 million, and \$1.29 billion, respectively, compared to totals as of December 31, 2020, of \$1.17 billion, \$954.9 million, and \$1.07 billion, representing year-over-year changes of 19%, -4%, and 20%, respectively.

It is worth noting that the decrease in loans is directly tied to the forgiveness of the U.S. Small Business Administration's Paycheck Protection Program (PPP) loans, which our bank originated in 2020 and 2021. As these loans were "forgiven," our loan balances decreased significantly from a peak amount of approximately \$167 million.

All of us are deeply grateful, not only for these results, but for our history over the last 22 years. I have found that when we have gratitude, we appreciate the value of something more deeply and are less likely to take what we have for granted. That is certainly the case here.

North State Bank began approximately 22 years ago with a vision and a set of values and beliefs that are still shared by all of us. At the core is our purpose, which is to add value to the lives of others while treating everyone with dignity and respect. That has not and will not change.

Before I make additional comments about what drives our performance and other related matters, I first want to reference Warren Buffett's annual letter to the shareholders of Berkshire Hathaway Inc. Mr. Buffett's letters are always interesting, educational, and clear. One of the things that struck me in his most recent letter is the number of times he referenced his friendship with his long-time partner, Charlie Munger. Mr. Buffett shares that they began working together in 1942 at Mr. Buffett's grandfather's grocery store. Later, Charlie became a lawyer and Warren started selling securities. Some years later, they both discovered what they really loved to do—to be custodians of invested funds for people who trusted them with a long-term approach to improving their wealth.



Larry D. Barbour
President and CEO

It's noteworthy that in this shareholder newsletter, Mr. Buffett uses the words "Charlie and I" 12 times. Obviously, there's a deep friendship here, which confirms for me that friendship and business can coexist in a healthy way. Mr. Buffett and Mr. Munger have proven that. Friendship is something we deeply believe in at North State Bank.

This "partnership" has worked well and has added value to the lives of so many people, not only financially, but in many other ways. In his letter, Mr. Buffett points out that the annual compounded gain from an investment in Berkshire Hathaway is 20.1%, dating back to 1965, over 56 years ago, for an overall gain of 3,641,613%. Wow!!

Why has Berkshire Hathaway been able to steadily and consistently improve the lives of so many people? And how is North State Bank managing to do the same?

Obviously, such results don't just happen but are the outcome of well-prepared intentions.

In line with that, banking is a very “human” business. Recently, I learned the CEO of Meta and his top officers are leaving the company headquarters in Silicon Valley to relocate in places around the world, including New York, Israel, Madrid, and Hawaii. The company said through a spokesman that *“we believe that how people work is far more important than where they work.”* However, Mr. Bill George, former CEO of Medtronic, Inc., and a senior fellow at Harvard Business School, tells us *“Your people want to see you. They want to know you're there. Yes, you can use Zoom or Microsoft Teams or something to stay in contact, but there's a lot to be said for presence.”*

There is much to be said for connection between people. I like what Dr. Brené Brown says about connection, which she defines as the *“energy that exists between people when they feel seen, heard, and valued; when they can give and receive without judgement; and when they derive sustenance and strength from their relationship.”* This clearly supports the truth that we are wired for connection. It is in our biology. From the time we are born, we need connection to thrive emotionally, physically, spiritually, and intellectually. This is not a hunch or some feeling. It's hard science—neuroscience to

be exact. So, relationships shape our biology, as well as our experiences.

If we want to live healthier, productive, fulfilled, and fruitful lives, we must satisfy this innate need for connection, because the consequences of disconnection are dangerous.

Technology today has become a kind of “imposter” for connection, making us believe we are connected when we're really not – at least not in the ways we need to be. Overreliance on technology leads to the “myth” of self-sufficiency. We simply cannot go alone. In fact, it's been said that *if you want to go fast, go alone. If you want to go far, go with others.*

We seem to have so much data and information available, we often stop there. As Nobel Prize-winning economist Herbert Simon said over 40 years ago, *“Information consumes the attention of its recipients. Hence a wealth of information creates a poverty of attention.”* We need to focus more on the people in our lives, not so much on the data.

In reference to the importance of connection and well-being, study and research has shown that people who work in close physical proximity to one another perform

Executive Management Team (clockwise) Chief People Officer **Amanda Lloyd**, Corporate Secretary **Stacey Koble**, Chief Credit Officer **Brian Hedges**, Chief Financial Officer **Stacy Reedy**, and Chief Operations Officer **Jonathan Kriebs**





Market Presidents (clockwise) **Casey Atwater**, West Raleigh; **Sabrina Sells**, Wilmington; **Kevin Payne**, Garner; **Sharon Moe**, Downtown Raleigh; **Bret Burgess**, North Hills; **June Sadowski**, Wake Forest; and **John Norwood**, North Raleigh

about 15% better than those who are separated from their colleagues. In fact, the farther apart people were, the more isolated and unhappy they felt. The bottom line is that when you're physically close to other people, you're better able to learn from one another and be more productive. In fact, seeing is learning. Leadership, growth, and development are very visual. We must stay close to each other.

Certainly, the pandemic contributed to social distancing and isolation. Although we must respect the strength of COVID and other illnesses, we cannot compromise our need to connect with other humans. We simply live better when we are connected.

In another study on social networks and connection, researchers used a formula in which the likelihood of connection between any two people decreases with the square of the distance between them. In other words, if people become twice as far apart, they become four times less likely to form a connection or a bond. Wow! So texting, videoconferencing, teleconferencing, and other means of communicating are simply unable to produce the connection for which we are wired.

One other interesting note along these lines is that the climate and environment of a company is critical. If

people are separated, it is impossible to improve the climate. Climate is not some meteorological term. It's an organization's working environment and the flexibility that frees employees to be innovative and unencumbered by red tape and bureaucracy. It creates a sense of responsibility to an organization with levels of standards that people accept and follow. In turn, people have clarity about the mission, values, and purpose of the organization and they develop a strong commitment to a common purpose. This is certainly true at North State Bank. I regularly see it firsthand through our people.

In fact, research also shows that one third of any company's results are attributed to climate or the environment in which the people work. That means, if you have a good environment, it's very likely that one third of your results came from a deeper level of commitment and better performance from your people.

So, I believe that the future will continue to be bright as we improve our levels of self-awareness and become more emotionally intelligent, as we add value to the lives of others, and as we treat them with the dignity and respect they deserve.

As much as I am still tempted to refer to the financial metrics and "leave it there," I cannot do that. This is a very

human business and humans are becoming underrated which is wrong and unwise. We need to get “back to human.” I don’t know how to say it more succinctly. I’ve said it before and now again. Technology is an “enabler” which should only help us spend more time “being human.”

I’ll conclude my remarks with a quote from Mr. Warren Buffett. I read this quote to my grandchildren recently, and at a young age, they were struck by Mr. Buffett’s comments. He says: *“Basically, when you get to be my age, you’ll really measure your success in life by how many people you want to love you actually do love you. I know people who have a lot of money, and they get testimonial dinners, and they get hospital wings named after them. But the truth is that nobody in the world loves them. If you get to my age in life and nobody thinks well of you, I don’t care how big your bank account is, your life is a disaster.”*

“That’s the ultimate test of how you have lived your life. The trouble with love is that you can’t buy it. You can buy testimonial dinners. You can buy pamphlets that say how wonderful you are. But the only way to get love is to be lovable. It’s very irritating if you have a lot of money.”

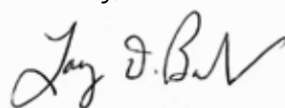
“You’d like to think you could write a check: I’ll buy a million dollars’ worth of love. But it doesn’t work that way. The more you give love away, the more you get.”

Looking back on what our people have done helps us to look forward. Someone once said that we are known by the company we keep. I have also learned that a company is known by the people it keeps.

I’m so deeply thankful for our people and their passion for helping others. A great question in life is, “Am I doing what I love, and am I loving what I do?” “Yes” is the answer our people give every day as they keep adding value to the people we serve.

We thank God for your support, your interest in our Company, your investment in this Company and, most of all, the trust you’ve placed in us through these years.

Cordially,



Larry D. Barbour
President and CEO



Division Presidents (l to r) **Larry Moran**, Government Lending;
Gary Woodlief, CommunityPLUS; and **Jonathan Hand**,
Specialized Lending Group

Independent Auditors' Report



To the Shareholders and the Board of Directors
North State Bancorp
Raleigh, North Carolina

Opinion

The accompanying condensed consolidated financial statements, which comprise the condensed consolidated balance sheets as of December 31, 2021 and 2020, and the related condensed consolidated statements of operations for each of the years then ended, are derived from the audited consolidated financial statements of North State Bancorp as of December 31, 2021 and 2020 and for each of the years then ended. We expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated March 23, 2022.

In our opinion, the condensed consolidated financial statements referred to above of North State Bancorp as of December 31, 2021 and 2020 and for each of the years then ended are consistent, in all material respects, with the audited consolidated financial statements from which they have been derived.

Condensed Consolidated Statements

The condensed consolidated financial statements do not contain all the disclosures required by accounting principles generally accepted in the United States of America. Reading the condensed consolidated financial statements and this auditor's report on the statements referred to above, therefore, is not a substitute for reading the audited consolidated financial statements of North State Bancorp and the auditors' report on them.

Management's Responsibility for the Condensed Consolidated Financial Statements

Management is responsible for the preparation of the condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America.

Auditors' Responsibility

Our responsibility is to express an opinion about whether the condensed consolidated financial statements are consistent, in all material respects, with the audited consolidated financial statements based on our procedures, which were conducted in accordance with auditing standards generally accepted in the United States of America. The procedures consisted principally of comparing the condensed consolidated financial statements with the related information in the audited consolidated financial statements from which the condensed consolidated financial statements have been derived, and evaluating whether the condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

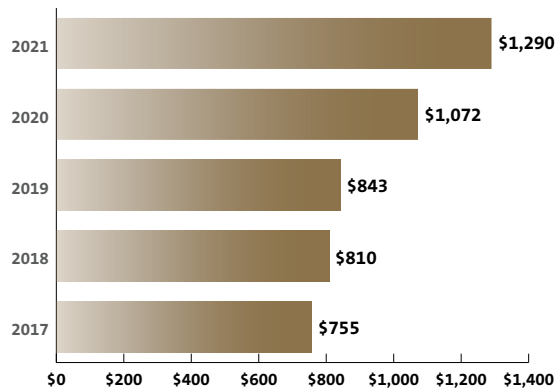
Dixon Hughes Goodman LLP

Raleigh, NC
March 23, 2022

Key Financial Graphs

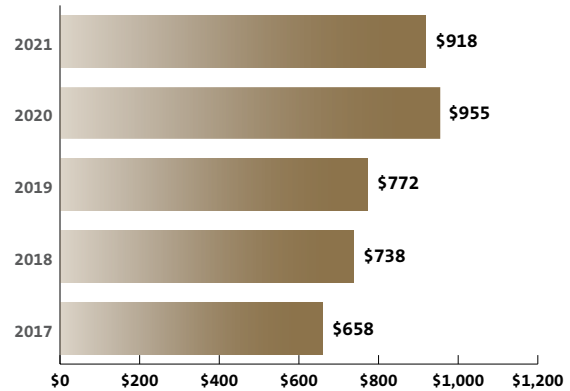
TOTAL DEPOSITS

(in millions)



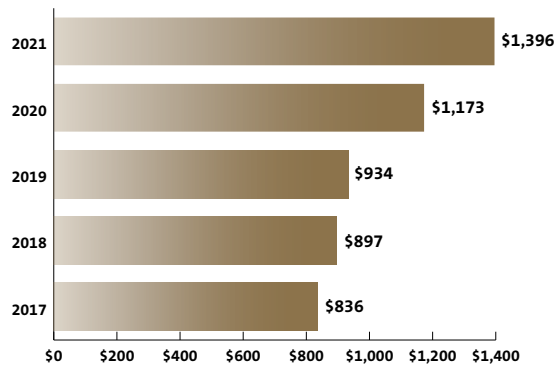
TOTAL LOANS

(in millions)



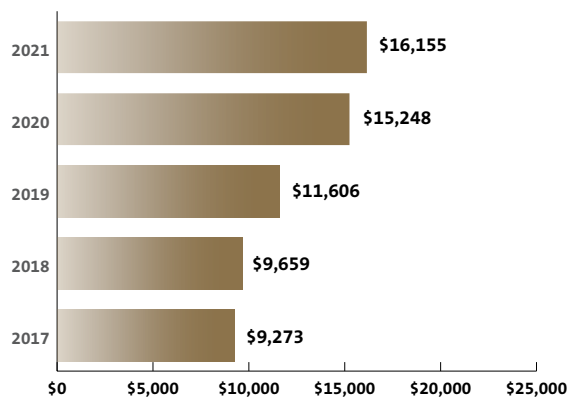
TOTAL ASSETS

(in millions)



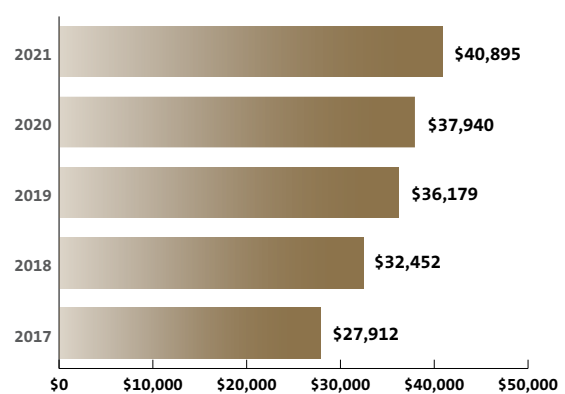
NET INCOME

(in thousands)



TOTAL NET INTEREST INCOME

(in thousands)



Selected Financial Highlights

	As of or for the Year Ended December 31,				
	2021	2020	2019	2018	2017
	(Dollars in thousands, except per share data)				
Operating Data:					
Total interest income	\$ 44,307	\$ 42,783	\$ 40,527	\$ 35,882	\$ 30,655
Total interest expense	<u>3,412</u>	<u>4,843</u>	<u>4,348</u>	<u>3,430</u>	<u>2,743</u>
Net interest income	40,895	37,940	36,179	32,452	27,912
Provision for (recovery of) loan losses	<u>-</u>	<u>5,040</u>	<u>680</u>	<u>700</u>	<u>(446)</u>
Net interest income after provision for (recovery of) loan losses	40,895	32,900	35,499	31,752	28,358
Non-interest income	17,539	24,942	12,387	14,508	18,346
Non-interest expense	<u>42,279</u>	<u>42,594</u>	<u>36,280</u>	<u>36,601</u>	<u>37,431</u>
Net income	<u>\$ 16,155</u>	<u>\$ 15,248</u>	<u>\$ 11,606</u>	<u>\$ 9,659</u>	<u>\$ 9,273</u>
Per Share Data:					
Earnings per share - basic	\$ 2.64	\$ 2.53	\$ 1.95	\$ 1.65	\$ 1.60
Tangible book value*	\$ 10.21	\$ 9.38	\$ 8.16	\$ 7.52	\$ 6.99
Weighted average shares outstanding:					
Basic	6,126,429	6,035,568	5,945,338	5,867,754	5,779,343
Selected Year-End Balance Sheet Data:					
Total assets	\$ 1,395,855	\$ 1,172,743	\$ 934,278	\$ 896,739	\$ 835,962
Loans - held for sale	7,218	27,500	16,480	17,216	33,183
Loans	917,982	954,864	771,662	738,368	658,436
Allowance for loan losses	6,742	6,518	4,931	4,164	3,951
Deposits	1,290,338	1,072,343	842,711	810,427	754,820
Borrowings	33,812	33,875	34,230	34,029	34,091
Shareholders' equity	65,157	59,260	50,973	46,043	41,897
Selected Average Balances:					
Total assets	\$ 1,305,156	\$ 1,150,534	\$ 939,150	\$ 879,174	\$ 835,915
Loans - held for sale	21,893	28,883	16,056	19,638	24,875
Loans	916,551	889,168	756,228	697,901	639,901
Total interest-earning assets	1,251,576	1,098,267	886,246	824,057	783,847
Deposits	1,200,348	998,062	847,993	793,492	755,239
Borrowings	33,886	88,337	34,141	34,419	34,087
Total interest-bearing liabilities	731,360	663,659	536,764	518,161	508,356
Shareholders' equity	62,904	55,038	49,595	45,064	41,124

* Non-GAAP financial measure.

As of or for the Year Ended December 31,

2021

2020

2019

2018

2017

(Dollars in thousands, except per share data)

Selected Performance Ratios:

Return on average assets	1.24%	1.33%	1.24%	1.10%	1.11%
Return on average equity	25.68%	27.70%	23.40%	21.43%	22.55%
Net interest spread	3.07%	3.16%	3.76%	3.66%	3.36%
Net interest margin	3.26%	3.45%	4.08%	3.91%	3.56%
Non-interest income to total revenue	28.36%	36.83%	25.51%	30.89%	39.66%
Non-interest income to average assets	1.34%	2.17%	1.32%	1.65%	2.19%
Non-interest expense to average assets	3.24%	3.70%	3.86%	4.16%	4.48%
Efficiency ratio	72.35%	67.74%	74.70%	77.94%	80.92%

Asset Quality Ratios:

Nonperforming loans to period-end loans	0.24%	0.38%	0.14%	0.13%	0.21%
Allowance for loan losses to period-end loans	0.73%	0.68%	0.64%	0.56%	0.60%
Ratio of allowance for loan losses to nonperforming loans	3.03x	1.80x	4.59x	4.43x	2.90x
Nonperforming assets to total assets	0.16%	0.31%	0.11%	0.10%	0.16%
Net charge-offs (recoveries) to average loans	(0.02%)	0.39%	(0.01%)	0.07%	(0.01%)

Capital Ratios (Bank Only):

Total risk-based capital	11.83%	11.60%	11.69%	11.24%	11.60%
Tier 1 risk-based capital	11.05%	10.82%	11.04%	10.67%	11.00%
CET 1 risk-based capital	11.05%	10.82%	11.04%	10.67%	11.00%
Leverage	7.08%	7.71%	8.91%	8.83%	8.68%
Equity to assets	4.67%	5.05%	5.46%	5.13%	5.01%
Average equity to average assets	4.82%	4.78%	5.28%	5.13%	4.92%

Other Data:

Number of banking offices	7	7	7	7	7
Number of full time equivalent employees	206	196	177	182	210

North State Bancorp Condensed Consolidated Balance Sheets

December 31, 2021 and 2020

	2021	2020
	<i>(Dollars in thousands)</i>	
ASSETS		
Cash and due from banks	\$ 9,426	\$ 12,486
Interest-earning deposits with banks	366,040	97,980
CDs with banks	101	100
Investment securities available for sale, at fair value	4,252	1,118
Investment securities held to maturity, at amortized cost	43,561	33,861
Loans held for sale	7,218	27,500
Loans	917,982	954,864
Less allowance for loan losses	6,742	6,518
Net loans	911,240	948,346
Accrued interest receivable	2,753	3,615
Federal Home Loan Bank and Federal Reserve stock, at cost	1,630	1,884
Premises and equipment, net	22,617	22,918
Bank owned life insurance	22,185	16,884
Prepaid for unexchanged common stock	3	125
Other assets	4,829	5,926
TOTAL ASSETS	\$ 1,395,855	\$ 1,172,743
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Demand	\$ 513,146	\$ 428,154
Savings, money market and NOW	716,306	579,316
Time	60,886	64,873
Total Deposits	1,290,338	1,072,343
Accrued interest payable	394	535
Payable for unexchanged common stock	3	125
Short-term borrowings	239	319
Long-term borrowings, net	33,573	33,556
Accrued expenses and other liabilities	6,151	6,605
TOTAL LIABILITIES	1,330,698	1,113,483
Commitments	—	—
Shareholders' equity		
Preferred stock, no par value, 1,000,000 shares authorized, none issued	—	—
Common stock, no par value, 8,136,382 shares authorized, 6,184,714 and 6,095,594 shares issued and outstanding, December 31, 2021 and 2020, respectively	11,215	9,668
Retained earnings	53,973	49,579
Accumulated other comprehensive (loss) income	(31)	13
TOTAL SHAREHOLDERS' EQUITY	65,157	59,260
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 1,395,855	\$ 1,172,743

North State Bancorp Condensed Consolidated Statements of Operations

Years Ended December 31, 2021 and 2020

	December 31,	
	2021	2020
	(Dollars in thousands, except per share data)	
INTEREST INCOME		
Loans	\$ 42,674	\$ 40,683
Loans held for sale	498	895
Investments	692	604
Dividends and interest-earning deposits	443	601
Total interest income	44,307	42,783
INTEREST EXPENSE		
Savings, money market and NOW	1,597	1,734
Time deposits	613	848
Short-term borrowings	—	185
Long-term borrowings	1,202	2,076
Total interest expense	3,412	4,843
Net interest income	40,895	37,940
PROVISION FOR LOAN LOSSES	—	5,040
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	40,895	32,900
NON-INTEREST INCOME		
Fees from mortgage operations	12,152	20,413
Fees and gains on sales from SBA operations	2,918	2,705
Other	2,469	1,824
Total non-interest income	17,539	24,942
NON-INTEREST EXPENSE		
Salaries and employee benefits	24,655	24,938
Occupancy and equipment	3,532	3,739
Data processing and other outsourced services	6,610	6,063
Net cost of foreclosed assets	6	5
Other	7,476	7,849
Total non-interest expense	42,279	42,594
NET INCOME	\$ 16,155	\$ 15,248
NET INCOME PER COMMON SHARE		
Basic	\$ 2.64	\$ 2.53
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING		
Basic	6,126,429	6,035,568

Corporate Board of Directors



Seated l to r: Burley Mitchell, Leslie Bristow, Leigh Ann Rotz, and Jule Smith. Standing l to r: Charles Francis, Forrest Ball, Fred Smith, Larry Barbour, Hal Perry, Reid Smith, and Jim Branch.

Forrest H. Ball

*President
Hartwell Realty, Inc.
Garner, NC*

Larry D. Barbour

*President and CEO
North State Bancorp
and North State Bank
Raleigh, NC*

James C. Branch

*Retired
Personal Investments
Raleigh, NC*

Leslie B. Bristow

*Co-Owner
Bristow Landscaping, LLC
Wake Forest, NC*

Charles T. Francis

*Attorney and Managing
Member
The Francis Law Firm, PLLC
Raleigh, NC*

The Honorable Burley B. Mitchell Jr.

*Retired Chief Justice
North Carolina Supreme Court
Raleigh, NC*

W. Harold (Hal) Perry

*Vice Chairman of the Board
North State Bancorp
Chief Executive Officer
Real Estate Marketing &
Consulting, Inc.
Raleigh, NC*

Leigh Ann P. Rotz

*Executive Vice President of
Operations
Real Estate Marketing &
Consulting, Inc.
Raleigh, NC*

Fred J. Smith Jr.

*Chairman of the Board
North State Bancorp
Chief Executive Officer
Fred Smith Company
Clayton, NC*

Fred J. "Jule" Smith III

*Chief Executive Officer
Construction Partners, Inc.
Raleigh, NC*

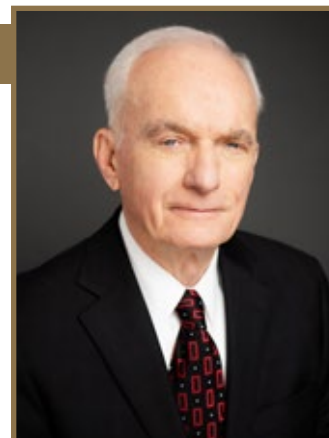
Reid M. Smith

*Founder and CEO
RiverWild
Clayton, NC*

DIRECTOR EMERITUS

Jack M. Stancil

*Private Investments
Retired Certified Public
Accountant
Founder and Past President
Stancil & Company
Raleigh, NC*



Local Advisory Boards

DOWNTOWN RALEIGH

David R. Crabtree

Anchor
WRAL-TV
Raleigh, NC

Robin M. Hammond

Retired Attorney
Raleigh, NC

John Latteri

Director of Development
Campbell University
Wiggins School of Law
Raleigh, NC

Rita Anita Linger, PhD

Executive Director
Recovery Communities
of North Carolina
Raleigh, NC

Andy Patrick Roberts

Partner
The Roberts Law Group, PLLC
Raleigh, NC

Kerry B. Saunders

*Business Development Consultant
& Project Manager*
Cary, NC

David L. Sherlin

Partner
Epstein Sherlin, PLLC
Raleigh, NC

The Reverend Charles R. Tyner Sr.

Executive Director
White Oak Foundation
Head Pastor
White Oak Missionary Baptist Church
Apex, NC

Thomas C. Worth Jr.

Attorney-at-Law
Raleigh, NC

M. Carter Worthy

President
Carter Worthy Commercial, Inc.
Raleigh, NC

GARNER

David J. Adams, DMD, MS

Owner
David J. Adams, DMD, PA
Garner, NC

Jonathan D. Adams

CPA - Managing Partner
John D. Adams & Company
Garner, NC

Douglas Ball

Member Manager
Ball Rentals
Garner, NC

David W. Bannister

President
Bannister Properties
Garner, NC

Johnny G. Blankenship

Vice President
Pipeline Utilities
Raleigh, NC

Lynda R. Herring

Attorney
Lynda R. Herring, PA
Garner, NC

Jerry E. Jones

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