

North State Bancorp (Not Publicly Traded)

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October 13, 2017

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Price (No recent trades)	N/A	EPS *	2016A:	\$1.80	P/E	2016A:	NA
52 Wk. Range:	N/A	(FY: DEC)	2017E:	\$1.76		2017E:	NA
Distributions (Estimated):	\$0.90		2018E:	\$ 1.88		2018E:	NA
Shares:	5.8 mm	Book Value: **		\$7.11	Price/Book Value:		NA

* Earnings per share are diluted. ** Tangible book value is \$6.95 per share.

Background

North State Bancorp (the "Company") is a single bank holding company headquartered in Raleigh, North Carolina with approximately \$839 million in assets as of September 30, 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.

Third Quarter Earnings Reflected High Profitability Despite Slowdown in Mortgage Area

North State Bank reported a solid third quarter. Although there was a sizable drop in fees from the mortgage operation (reflecting a nationwide slowdown in mortgage activity), a good deal of that decline was offset by: 1) a strong showing in SBA income; 2) higher net interest income, and 3) excellent cost containment. Moreover, even though earnings were below the year-ago level, they were still high relative to the Bank's asset and equity base, meaning that traditional metrics such as ROAE and ROAA were quite high. Specifically, annualized return on average assets was 1.34% in the quarter, while ROAE was 26.85% (both figures are untaxed) Asset quality was good as well, as the NPAs/assets ratio was only 0.25%, which is lower than the year-ago figure and close to a 10-year low for the Company.

Performance Ratios at a Glance, Q3 2017 (%)	
ROAA *	1.34
ROAE *	26.85
Net Int. Margin	3.57
NPAs/Assets	0.25
* S-Corp. earnings are untaxed.	

3RD QUARTER HIGHLIGHTS:

EPS: \$0.49 vs. \$0.59

NET INTEREST INCOME GREW 13%

THE MARGIN INCREASED 18 BASIS POINTS AND SBA LENDING MORE THAN DOUBLED

ALTHOUGH MORTGAGE INCOME WAS DOWN, THAT WAS PARTLY OFFSET BY STRENGTH IN THE SBA AREA

NONINTEREST EXPENSE WAS DOWN 1%

YEAR-TO-DATE HIGHLIGHTS:

EPS: \$1.31 vs. \$1.33

NET INTEREST INCOME INCREASED 9%

FROM SEPTEMBER 30, 2016 TO SEPTEMBER 30, 2017:

ASSETS INCREASED 5%

NET LOANS AND DEPOSITS 6%

TOTAL DEPOSITS IN WAKE COUNTY INCREASED 25% OVER THE PAST FIVE YEARS

NPAS WERE DOWN FROM THE YEAR-AGO DATE

NPAS/ASSETS: 0.25%

RESERVES/LOANS: 0.68%

EPS PROJECTIONS

2016A: \$ 1.80
2017E: \$ 1.76
2018E: \$ 1.88

to 3.57% in 2017's third quarter from a year-ago level of 3.39%. Average earning assets grew about 7% over the same period. As was stated above, the one area of weakness in the quarter was mortgage related fees, although the Company absorbed that drop quite well. The magnitude of the drop was large, as fees from mortgage operations declined roughly \$2 million to \$3,625,000 in 2017's third quarter from \$5,621,000 in 2016's third quarter. Fortunately, SBA-related fees and gains on sale more than doubled to \$1,182,000 in the third quarter of 2017 from \$517,000 in the year-ago quarter, mitigating the effects of the mortgage slowdown. The net effect was that noninterest income declined 19% to \$5,213,000 in 2017's third quarter from \$6,459,000 in the year-ago quarter. The effects were also mitigated by excellent cost containment, as noninterest expense declined 1% to \$9,508,000 in the third quarter of 2017 from \$9,644,000 in the year-ago quarter, mainly due to lower personnel expense. There was no provision for loan losses for 2017's third quarter, compared to a credit for loan losses of \$167,000 in the year-ago quarter.

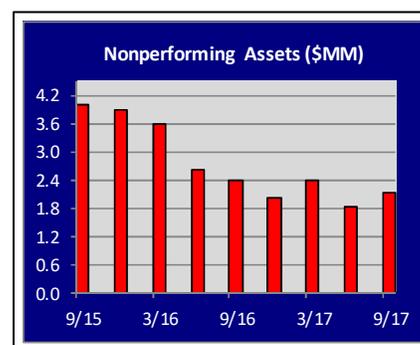
Nine Months Earnings Were Stable

Earnings for the first nine months of 2017 were essentially unchanged compared to the first nine months of 2016, although we would note that there was \$228,000 in security gains in the year-ago period (there were none in the current period), meaning that operating earnings actually increased. Untaxed net income was \$7,575,000, or \$1.31 per diluted share for the nine months ended September 30, 2017, compared to \$7,514,000, or \$1.33 per diluted share, in the year-ago period. Net interest income increased 9%, while noninterest income, excluding security gains, was down 8%. Cost control was also evident, as noninterest expense increased less than 1% compared to the year-ago period.

Balance sheet growth has also been fairly controlled, generally in the 5-6% range for assets (5%) and net loans and deposits (6%) over the past year. Given the Company's capital position (at September 30, 2017, shareholders' equity was \$41.1 million, or 4.90% of assets), we expect balance sheet growth to remain in the low- to mid-single digits. One aspect of North State's growth that we consider significant is its progress building deposits, most of which are located in Wake County. Wake County is a rapidly growing, dynamic market with highly attractive demographics, and North State has a growing market presence in that market. Looking at the FDIC market share statistics that are released each June, we see that North State grew its Wake County deposits by 25% from June 30, 2012 to June 30, 2017. What is more, over that period, its deposit market share grew from 2.48% to 2.70% and there was only one year in which market share did not increase from the previous year. Given the competitive intensity of the Wake County market (there are 32 institutions serving it), we consider that quite impressive.

Nonperforming Assets Decreased 10%

As of September 30, 2017, North State Bancorp had nonperforming assets of \$2.1 million, or 0.25% of total assets, versus \$1.8 million, or 0.22% of assets, at June 30, 2017, and \$2.4 million, or 0.30% of total assets, at the year-ago date. As can be seen from the adjacent chart, the long-term trend in NPAs remains positive. The allowance for loan losses was \$4.4 million, or 0.68% of total loans, at September 30, 2017, compared to \$5.9 million, or 0.97% of total loans, at the year-ago date.



Projections

Based on the most recent results, we are lowering our projections for 2017 to \$10.1 million, or \$1.76 per diluted share, and 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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