

North State Bancorp (Not Publicly Traded)

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Raleigh
North Carolina
27609

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Price: *	\$16.55	EPS *	2021A:	\$2.64	P/E	2021A:	6.3x
52 Wk. Range:	\$16.55 - 19.75	(FY: DEC)	2022A:	\$2.08		2022A:	8.0x
Distributions (Estimated):*	\$1.45		2023E:	\$2.26		2023E:	7.3x
Shares:	6.4 mm	Book Value:		\$11.14	Price/Book Value:		1.49x

* Stock is not actively traded. Last known trade. Tangible book value is \$10.80. Distributions are estimates based on 70% of EPS.

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ASSETS: \$1.3 BB

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4TH QUARTER HIGHLIGHTS:

ACTUAL RESULTS WERE ABOVE ESTIMATES

EPS: \$0.57 vs. \$0.37

THERE WAS A CREDIT FOR LOAN LOSSES OF \$360K IN Q4 21 VERSUS A PROVISION OF \$60K IN Q4 22, AS WELL AS SUBSTANTIALLY HIGHER PPP FEES IN THE YEAR-AGO QUARTER

EXCLUDING THESE TWO ITEMS, EARNINGS WOULD HAVE MORE THAN DOUBLED

NET INTEREST INCOME INCREASED 27%, DRIVEN BY IMPROVEMENT IN MARGINS

A DROP IN MORTGAGE FEE INCOME WAS PARTLY OFFSET BY STRONG GROWTH IN OTHER NONINTEREST INCOME AREAS

Background

North State Bancorp (the “Company”) is a single bank holding company headquartered in Raleigh, North Carolina with approximately \$1.3 billion in assets as of December 31, 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 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 EPS Beat Estimates; Operating Trends Remain Quite Strong

For the fourth quarter of 2022, North State Bancorp reported excellent results that outperformed our projections. While total revenues continued to be impacted by the slowdown in mortgage banking, that was more than offset by strong momentum in net interest income. Expenses were well contained and declined from the year-ago quarter, partly due to year-ago demolition expenses related to the West Raleigh office (nonrecurring), although it was also due to solid expense management. Other factors that affected the comparisons were the presence of significant PPP fee accretion in the year-ago quarter and differing provisions/credits for loan losses. Finally, we would note that loan growth remained strong and, while nonperforming assets increased, asset quality and reserve adequacy remained sound.

In terms of specific results, North State Bancorp reported net income of \$3,596,000, or \$0.57 per share, in 2022’s fourth quarter, up from \$2,286,000, or \$0.37 per share, in the year-ago quarter. As was stated above there were widely varying provisions, as well as nonrecurring expenses in the year-ago quarter. Excluding the provision for loan losses, PPP fees earned in the year-ago period and nonrecurring expenses, the “normalized” earnings were closer to \$3.7 million, more than double the year-ago figure.

Quarterly Results (\$000s)	2021 Q4	2022 Q4
Net Income	2,286	3,596
Adjustments:		
Provision (Add/Deduct Credits)	(360)	60
Nonrecurring Exp. (Office Demo)	585	-
Net PPP Loan Fee Accretion	870	-
Inc. Bef. Prov./PPP Fees/Nonrecurr. Exp.	1,641	3,656

Most of the core earnings strength came from net interest income, which was up 27% to \$12,806,000 in 2022’s fourth quarter from \$10,119,000 in the year-ago quarter, due to solid net interest margin expansion. (Excluding net PPP fees, net interest income increased an even more impressive 38%.) Net interest income benefitted from a much higher margin in the quarter (the margin grew 92 basis points to 3.99% in 2022’s fourth quarter from 3.07% in the year-ago quarter), primarily reflecting the bank’s redeployment of funds from lower yielding cash and investments into higher yielding loans. Offsetting some of this strength was a drop in noninterest income, which was \$1,842,000 in 2022’s fourth quarter, versus \$2,931,000 in the year-ago quarter. Excluding the drop in the mortgage fees, noninterest income would have grown about 17%, so the important point is that the underlying trends in many other areas of noninterest income are showing good momentum.

THE BANK IS COMING OUT WITH SOME NEW MORTGAGE PRODUCTS TO STIMULATE ORIGINATIONS

EXPENSE CONTROL WAS GOOD

THE ROAA, ROAE, MARGIN AND EFFICIENCY RATIO ALL IMPROVED FROM Q4 21 TO Q4 22

THE ROAE WAS 20.6% AND WAS ESPECIALLY STRONG

FULL YEAR 2022 HIGHLIGHTS:

EPS: \$2.08 vs. \$2.64

NET INTEREST INCOME WAS UP 12%

FROM 12/31/21 TO 12/31/22:

NET LOANS GREW 14%, WHILE DEPOSITS AND TOTAL ASSETS WERE DOWN 8% AND 7% RESPECTIVELY

EQUITY/ASSETS: 5.43%

CAPITAL REINVESTMENT PLAN RAISED \$2.26 MM IN NEW CAPITAL IN 2022

NPAS/ASSETS: 0.46%

RESERVES/LOANS: 0.72%

EPS:
2021A: \$ 2.64
2022A: \$ 2.08
2023E: \$ 2.26

Mortgage operations income only accounted for about 22% of total noninterest income in 2022's fourth quarter (versus 58% in the year-ago quarter), so the impact of future weakness in this area should have a diminishing impact on earnings. Finally, as we previously noted, earnings benefitted from good containment of expenses, as noninterest expense was \$10,992,000 in the fourth quarter of 2022, down from \$11,124,000 in the year-ago quarter.

Another accomplishment of the fourth quarter of 2022 was that North State continued to achieve impressive performance metrics. As can be seen from the adjacent table, the ROAA, ROAE and the net interest margin all had substantial improvement compared to the year-ago quarter, and the efficiency ratio declined (showing improvement). We were particularly impressed with North State's annualized ROAE for 2022's fourth quarter of 20.6%, which has steadily increased over the past year. The Company's ability to earn a high ROAE reflects several key success factors at the Bank, such as a creative and inexpensive funding strategy ("CommunityPlus"), the building of highly scalable and lucrative noninterest income sources and its discipline for containing costs. From an investor's standpoint, achieving a high ROAE is one of the most critical metrics that drives long-term performance.

	North State	
	Q4 21	Q4 22
ROAA	0.67	1.06
ROAE	14.10	20.57
Net Int. Mrgn.	3.07	3.99
Efficiency Ratio	85.24	75.04

Full Year Results Were Also Strong

Results for the full year 2022 were likewise impacted by differing provisions, highly varying mortgage and SBA income, PPP fees and nonrecurring expenses. Net income for the full year 2022 was \$13,068,000, or \$2.08 per share, compared to \$16,155,000, or \$2.64 per share, in the year-ago period. However, there was no provision for loan losses in the year 2021, versus a provision of \$665,000 in 2022, and PPP fees were \$4.2 million in 2021 versus \$0.2 million in 2022. Excluding these items and the nonrecurring expenses in 2021, the adjusted earnings actually were up about 8% in 2022 relative to 2021. Net interest income grew 12%, noninterest income decreased 35% and noninterest expense (excluding the nonrecurring demo expense) was up 5% over this period.

Loans Increased 14% Over the Past Year

North State's balance sheet growth from December 31, 2021 to December 31, 2022 was led by loans, the majority of which was organic, as all PPP loans have rolled off the books. More specifically, net loans increased 14%, while deposits and total assets declined 8% and 7%, respectively. The Company remained well-capitalized as of December 31, 2022, with all of the Bank's regulatory capital ratios exceeding "well capitalized" minimums. Shareholders' equity was \$70.9 million, or 5.43% of total assets, at December 31, 2022. One thing that is boosting capital is the Company's highly successful Capital Reinvestment Plan, which started in 2022. Shareholders can invest up to 50% of their quarterly distributions to purchase additional shares. In 2022 (a partial year for the program), the plan raised \$2.26 million in new capital, boosting capital ratios by 24 basis points.

North State's Reserve for Loan Loss Grew 12%

North State had nonperforming assets (all of which were nonaccrual loans) of \$6.0 million, or 0.46% of total assets, as of December 31, 2022, compared to \$2.6 million, or 0.19% of total assets, at September 30, 2022 and \$2.2 million, or 0.16% of total assets, at the year-ago date. The allowance for loan losses was \$7.5 million (0.72% of total loans) at year-end 2022, up from \$6.7 million (0.73% of total loans) at the year-ago date.

Projections

For the year 2023, we are estimating North State Bancorp will earn \$14.7 million, or \$2.26 per share. Actual earnings could vary substantially from these projections given the economic uncertainties.

ADDITIONAL INFORMATION UPON REQUEST

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