

## North State Bancorp (Not Publicly Traded)

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Raleigh  
North Carolina  
27609

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<b>Price: *</b>	\$16.55	<b>EPS *</b>	<b>2021A:</b>	\$2.64	<b>P/E</b>	<b>2021A:</b>	6.3x
<b>52 Wk. Range:</b>	\$16.55 - 16.55	(FY: DEC)	<b>2022A:</b>	\$2.08		<b>2022A:</b>	8.0x
<b>Distributions (Estimated):*</b>	\$1.36		<b>2023E:</b>	\$1.95		<b>2023E:</b>	8.5x
<b>Shares:</b>	6.4 mm	<b>Book Value:</b>		\$11.37	<b>Price/Book Value:</b>		1.46x

\* Stock is not actively traded. Last known trade. Tangible book value is \$11.05. Distributions are estimates based on 70% of EPS.

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**ASSETS: \$1.3 BB**

**HQ: RALEIGH, NC**

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**1<sup>ST</sup> QUARTER HIGHLIGHTS:**

**RESULTS WERE IN LINE WITH PROJECTIONS**

**EPS: \$0.56 VS. \$0.46 IN THE YEAR-AGO QUARTER**

**THERE WAS A PROVISION FOR CREDIT LOSSES OF \$115,000 VS. NO PROVISION IN THE YEAR-AGO QUARTER, AND THERE WAS PPP FEE ACCRETION OF \$141K IN THE YEAR-AGO QUARTER, VS. NONE IN Q1 23**

**EXCLUDING THESE TWO ITEMS, EARNINGS WOULD HAVE INCREASED 36%**

**NET INTEREST INCOME GREW 33%**

**MARGINS IMPROVED 133 BASIS POINTS, WHILE EARNING ASSETS DECREASED 13%**

### 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 March 31, 2023. 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.

### First Quarter Earnings Momentum Remained Excellent

North State Bancorp reported another solid quarter in the three months ended March 31, 2023. Earnings were up sharply, benefiting from significant margin improvement that has resulted as the Bank’s earning assets have increasingly shifted from cash and investments (lower yielding) to loans (higher yielding). The key to much of this progress has been the strong underlying loan growth, as many areas of the balance sheet (cash, deposits and total assets) have actually contracted as seen across the entire financial sector. The result has been that the Bank is generating higher returns on those earning assets, which has allowed earnings to increase despite a drop in the overall level of earning assets. Bottom line, that strategy, along with the high ROE and an attractive Capital Reinvestment Plan, which is discussed later, have helped to sustain capital ratios (the leverage ratio has actually increased). Finally, we would note that asset quality remained good. Although nonperforming assets were up from the year-ago date, they were essentially unchanged from the year-end 2022 level.

North State reported net income of \$3,583,000, or \$0.56 per share, for the first quarter of 2023, which was up 25% from \$2,867,000, or \$0.46 per share, in the year-ago quarter. As has occurred in previous quarters, there was a bit of “noise” in both quarters, in that there were differing provisions for loan losses (\$115,000 in 2023’s first quarter versus no provision in 2022’s first quarter) and there was no PPP fee income in the first quarter of 2023, as compared to \$141,000 in PPP fee accretion in the year-ago quarter. If we exclude these factors, we see that “normalized” earnings increased 36% from the first quarter of 2022, as seen in the adjacent table.

First Quarter Results (\$000s)	2022	2023
Net Income	2,867	3,583
Adjustments:		
Provision (Add/Deduct Credits)	-	115
Net PPP Loan Fee Accretion	(141)	-
<b>Inc. Bef. Prov./PPP Fees/Nonrecurr. Exp.</b>	<b>2,726</b>	<b>3,698</b>

Net interest income was the driver of the earnings growth, as it was up 33% to \$12,748,000 in 2023’s first quarter, from \$9,581,000 in the year-ago quarter. (It grew 35% excluding PPP fee income.) Margins have been particularly strong in the past year and were up 133 basis points to 4.12% in 2023’s first quarter from 2.79% in the year-ago quarter, more than offsetting a roughly 13% drop in earning assets over the same period. The strength in net interest income more than offset ongoing softness in noninterest income, which decreased 44% to \$2,077,000 in 2023’s first quarter from \$3,724,000 in the

NONINTEREST INCOME  
DECREASED DUE TO LOWER  
MORTGAGE AND SBA  
OPERATIONS FEES

NONINTEREST EXPENSE WAS UP  
7%

PERFORMANCE RATIOS  
IMPROVED AND WERE  
IMPRESSIVE

FROM MARCH 31, 2022 TO  
MARCH 31, 2023:

NET LOANS INCREASED 15%,  
WHILE DEPOSITS DECREASED  
13% AND ASSETS WERE DOWN  
12%

EQUITY/ASSETS: 5.70%

CAPITAL REINVESTMENT PLAN  
HAS BEEN AN IMPORTANT  
SOURCE OF NEW CAPITAL

NPAS/ASSETS: 0.46%

RESERVES/LOANS: 0.67%

EPS:  
2021A: \$ 2.64  
2022A: \$ 2.08  
2023E: \$ 1.95

year-ago quarter. Headwinds in this area included a drop in mortgage fees (not surprising given the increase in mortgage rates), as well as lower fees/gains on SBA operations (driven by a decrease in sales of SBA loans). On the positive side, though, mortgage and SBA currently only accounted for 42% of noninterest income in 2023's first quarter, versus 84% in the year-ago quarter, so the concentration in these two key (but highly variable) areas has dropped. Noninterest expense totaled \$11,127,000 in 2023's first quarter, up 7% from \$10,438,000 in the year-ago quarter, with the growth partly reflecting higher charitable contributions. (The Bank has a strong and long-term commitment to supporting community-oriented and similar nonprofit organizations.) Finally, as can be seen in the adjacent table, we would note that several of the key performance metrics improved meaningfully in 2023's first quarter.

Profitability & Efficiency Ratios (%)		
	North State	
	Q1 22	Q1 23
ROAA	0.80	1.09
ROAE	17.92	20.35
Net Int. Mrgn.	2.79	4.12
Efficiency Ratio	78.45	75.06

### Loans Grew 15%

As we mentioned earlier, balance sheet growth continues to be mainly in loans, with assets and deposits dropping over the past year. Specifically, from March 31, 2022 to March 31, 2023, net loans increased 15%, while deposits were down 13% and assets dropped 12% in line with local and national trends. We continue to be impressed with North State's loan growth, all of which was organic given that all PPP loans have rolled off the books. In terms of capital, shareholders' equity totaled \$73.2 million, or 5.70% of total assets at March 31, 2023, versus \$65.3 million, or 4.50%, at the year-ago date. One point we would mention is that North State does not have a large investment portfolio of fixed income securities, and as a result, the losses on its accumulated other comprehensive income account (which are unrealized losses on the Bank's "available for sale" investment portfolio) were relatively modest at \$680,000. These losses are expected to moderate over time.

### Capital Reinvestment Plan Has Been Highly Successful

One of the more creative strategies that the Company has implemented to boost capital ratios while remaining below the 100-shareholder maximum that it can be as an S-Corporation is a Capital Reinvestment Plan that was adopted in 2022. Under this program, each shareholder is allowed to spend up to 50% of their quarterly distribution to purchase additional shares. During 2022, the plan raised \$2.26 million in additional capital, which boosted its capital ratios by 24 basis points. In the most recent quarter, another \$883,000 was raised, and the additional capital raised capital ratios by seven basis points.

### NPAs Increased But Asset Quality is Still Good

As of March 31, 2023, North State had nonperforming assets (all of which were nonaccrual loans) of \$5.9 million, or 0.46% of total assets, as compared to \$6.0 million, or 0.46% of total assets, at December 31, 2022, and \$1.9 million, or 0.13% of total assets, at the year-ago date. The allowance for credit losses totaled \$7.3 million, or 0.67% of total loans, as of March 31, 2023, which was up 8% from \$6.8 million (0.71% of total loans) at the year-ago date.

### Projections

Based on the rapid increase in interest rates, costs on deposit accounts have grown significantly, negatively impacting margins across all financial institutions. We now believe there could be a temporary drop in earnings until margins recover, and are revising our earnings projection to \$12.5 million, or \$1.95 per share. Actual earnings could vary substantially from these projections given volatile interest rates and other economic uncertainties.

#### ADDITIONAL INFORMATION UPON REQUEST

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