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# North State Bancorp (Not Publicly Traded)

**John A. (Buddy) Howard, CFA**
**July 8, 2021**

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Price: *** | $18.30 | **EPS** | **2019A:** | $1.95 | **P/E** | **2019A:** | 9.4x |
| **52 Wk. Range:** | N/A | (FY: DEC) | **2020A:** | $2.53 | | **2020A:** | 7.2x |
| **Distributions (Estimated):** | $1.81 | | **2021E:** | $2.30 | | **2021E:** | 8.0x |
| **Shares:** | 6.1 mm | **Book Value:** | | $10.46 | **Price/Book Value:** | | 1.75x |

* Stock is not actively traded. Last known trade. Tangible book value is $10.09.

**ASSETS: $1.3 BB**

**HQ: RALEIGH, NC**

**CONTACT:**
**STACY REEDY**
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## 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 June 30, 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.

**2ND QUARTER HIGHLIGHTS:**

**NET INCOME GREW 45%, WITH LOWER MORTGAGE FEES BEING OFFSET BY HIGHER NET INTEREST INCOME, A LOWER PROVISION AND A DROP IN NONINTEREST EXPENSE**

**EPS: $0.71 VS. $0.49**

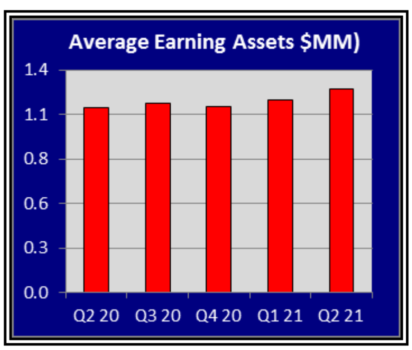
**NET INTEREST INCOME WAS UP 6%**

**AVERAGE EARNING ASSET GROWTH OFFSET LOWER MARGINS**

**NONINTEREST INCOME DECREASED DUE TO LOWER MORTGAGE OPERATIONS FEES**

## Second Quarter EPS Was Up Sharply From the Year-Ago Figures

For the second quarter of 2021, North State Bancorp reported significantly higher earnings that were right in line with our projections. As we had expected, the recent surge of mortgage originations abated, leading to a large drop in mortgage fee income. However, that drop was more than offset by: 1) a drop in the provision for loan losses, reflecting the Bank's favorable asset quality and reserve adequacy metrics; 2) higher net interest income, which among other things, benefitted from an increase in the accretion of deferred PPP fees, and 3) lower noninterest expense, reflecting the Bank's variable (i.e., commission based) cost structure in the mortgage area. Bottom line, even though mortgage fees dropped significantly, the reported earnings were up about 45%. Balance sheet growth was fairly controlled, with positive growth from the year-ago level but declines in several areas on a linked quarter basis due to payoffs/forgiveness of PPP loans. Finally, as was implied by the lower provision for loan losses, asset quality was excellent.




**NET INTEREST MARGIN (%)**

| Q2 '20 | Q3 '20 | Q4 '20 | Q1 '21 | Q2 '21 |
|---|---|---|---|---|
| 3.35 | 3.33 | 3.41 | 3.55 | 3.18 |

In terms of specifics, earnings for the second quarter of 2021 were $4,330,000, or $0.71 per share, up from $2,982,000, or $0.49 per share, in the year-ago quarter. Net interest income totaled $9,775,000 (including $856,000 in deferred PPP loan fee accretion) for the second quarter of 2021, up 6% from $9,196,000 (including $583,000 in deferred PPP loan fee accretion) in the year-ago quarter. Not surprisingly, margins remain under pressure, although strong average earning asset comparisons are more than offsetting that contraction (see the adjacent table and chart). Looking ahead, we expect margins to begin inching up and, particularly as PPP loans are forgiven, average earning assets to moderate. As was mentioned above, one of the largest drivers of the higher earnings was the improvement in the provision for loan losses. Whereas there was a provision for loan losses of $1,645,000 in the year-ago quarter, there was a release of $550,000 in 2021's second quarter due to strong recoveries, low delinquencies and higher than normal reserves coverage ratios.

NONINTEREST EXPENSE DECREASED 5%

ROAA AND ROAE WERE IMPRESSIVE

Noninterest income decreased 31% to $4,406,000 in 2021's second quarter, from $6,343,000 in the year-ago quarter, the majority of which came from the decline in mortgage fees. Importantly, though, noninterest income *excluding* mortgage fees increased 45% in the quarter, mainly on account of higher SBA related income. So even though total noninterest income was lower, there were solid comparisons in several areas other than the mortgage operation. Finally, noninterest expense decreased 5% to $10,401,000 for the second quarter of 2021 from $10,912,000 in the year-ago quarter. Profitability ratios were exceptional, with annualized ROAA of 1.35% in 2021's second quarter, while annualized ROAE was 27.6%.

FIRST HALF HIGHLIGHTS:

EPS: $1.68 VS. $0.94

EARNINGS WERE UP 81%

For the first half of 2021, reported net income was $10,266,000, or $1.68 per share, versus $5,683,000, or $0.94 per share, for the year-ago period. Net interest income was up 12%, noninterest income grew 5% and noninterest expense was essentially flat. The provision for loan losses was $110,000 for the six months ended June 30, 2021, versus $1,870,000 in the year-ago period.

NORTH STATE HAS HAD EXCELLENT BALANCE SHEET GROWTH

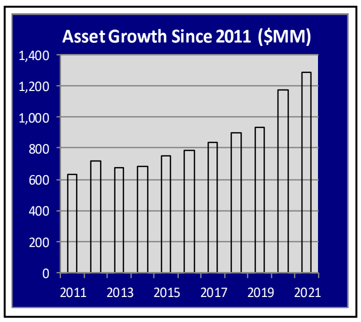
WHILE THIS ACCELERATED IN THE PAST COUPLE OF YEARS, IT IS LIKELY TO MODERATE

A CONTROLLED GROWTH APPROACH IS ACTUALLY QUITE CONSISTENT WITH NORTH STATE'S FOCUS ON HIGH PROFITABILITY METRICS AND EARNINGS

THE STOCK CURRENTLY HAS AN "EXPECTED" SHAREHOLDER DISTRIBUTION YIELD IN THE LOW DOUBLE DIGITS

**Looking Ahead, Balance Sheet Growth is Likely to Moderate**

As can be seen from the adjacent chart, North State has had strong balance sheet growth over the years, which accelerated over the past couple of years with the surge of PPP loans and related deposits. While the pandemic took a terrible toll on the world at large, our country and families, one thing that it also did was to provide an opportunity for North State Bank to demonstrate its ability to originate loans quickly (PPP loans in particular), as well as to provide support for small businesses generally. As a result, the Bank has picked up many new banking relationships which are likely to remain at the Bank for years to come. While that should lead to ongoing market share gains for the Bank, we do expect growth to moderate in coming quarters. In many ways, though, a moderated growth rate fits in with North State's overall strategy, which is to focus on profitability, cash flow and shareholder distributions, more so than on the size of the balance sheet. After all, taking a controlled growth approach allows a bank to be more selective about which credits to fund and to be able to be more disciplined in pricing deposits. North State Bancorp's strategy of focusing on earnings has been quite effective: based on the most recent price of the stock of which we are aware (shares rarely change hands), the yield is in the low double digits.



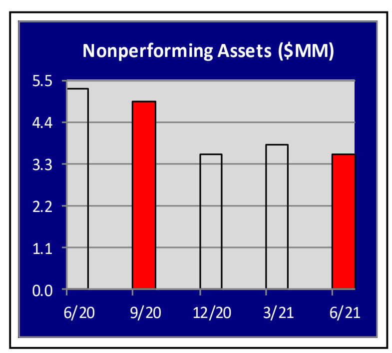

ASSET QUALITY REMAINS IN GREAT SHAPE

NPAS/ASSETS: 0.27% VS. 0.46% AT THE YEAR-AGO DATE

RESERVES/LOANS: 0.77% VS. 0.69% AT THE YEAR-AGO DATE

**Nonperforming Assets Were Down 35% From the Year-Ago Date**

North State's asset quality has continued to improve, with nonperforming assets decreasing from the year-ago date and also on a linked quarter basis. Nonperforming assets ("NPAs", excluding restructured loans) totaled $3.5 million, or 0.27% of total assets, at June 30, 2021, which was down 8% from $3.9 million, or 0.30% of total assets, at March 31, 2021, and down 36% from $5.6million, or 0.46% of total assets, at the year-ago date. The allowance for loan losses increased 8% to $7.0 million, or 0.77% of total loans, at June 30, 2021, from $6.5 million, 0.71% of total loans, at June 30, 2020.




EPS:
2019A: $ 1.95
2020A: $ 2.53
2021E: $ 2.30

**Projections**

We are maintaining our 2021 earnings projections at $14.1 million, or $2.30 per share. We would note that we expect the provision to remain volatile for the next several quarters given the continued economic uncertainty. As stated previously, actual earnings could vary substantially from these projections given the economic uncertainties.

ADDITIONAL INFORMATION UPON REQUEST