

AVAILABLE ON THE WEB AT [WWW.EQUITYRESEARCH.COM](http://www.equityresearch.com)

Paragon Commercial Corporation (OTC QX - PBNC)

5003 Falls of Neuse Road

Raleigh
North Carolina
27609

919-876-8868 ph

www.equityresearch.com

John A. (Buddy) Howard, CFA
May 5, 2016

Price: *	\$27.20	EPS **	2014A:	\$ 1.77	P/E	2014A:	15.4x
52 Wk. Range:	\$22.00 - \$28.50	(FY: DEC)	2015A:	\$ 2.47		2015A:	11.0x
Div/Div Yld:	\$0.00 / 0.0%		2016E:	\$ 2.66		2016E:	10.2x
Shrs/Mkt Cap:	4.6 mm / \$125 mm	Book Value:		\$ 21.87	Price/Book Value:		1.24x

* Limited trading. ** Diluted.

Background

Paragon Commercial Corporation (the “Company”) is a Raleigh, North Carolina-based commercial bank holding company for Paragon Bank (the “Bank”), a bank that began operations on May 10, 1999. With approximately \$1.3 billion in assets as of March 31, 2016, the Bank focuses on business banking and private banking. The Bank conducts operations through locations in Raleigh, NC, Charlotte, NC, Cary, NC and an operations center (Raleigh, NC). Paragon Commercial Corporation offers a broad array of products to commercial clients, business owners and other targeted private banking customers, either through its own products or through affiliated companies that have partnered with the Bank. Commercial and private banking products and services offered include check and statement imaging, business checking, money market investment accounts, certificates of deposit, letters of credit, online banking and business loans. Paragon also offers commercial insurance, retirement plans, leasing, and investment services, commercial real estate financing, residential mortgages and accounts receivable funding through the third party providers. The Bank also provides a variety of financial products and services exclusively to individuals who desire a comprehensive banking relationship, from premium checking, money market and certificate of deposit accounts to customized financing solutions for personal and business needs. The shares are quoted on the OTC QX marketplace under the symbol “PBNC”).

First Quarter EPS Was Up 22%

Paragon Commercial Corporation reported strong first quarter earnings that were a nice improvement from the year-ago numbers. Even though the results were actually a bit below what we were projecting, the improvement was still quite impressive (EPS was up 22%) and the momentum in a number of key areas was encouraging. Balance sheet growth was strong, driven mainly by loans, and recent hires should help to maintain that momentum. Asset quality continued the favorable trend that it has been in for some time, and given that the Bank has negligible nonaccrual loans today, we expect the provision for loan losses to remain low for at least the next few quarters. We would also note that, based on its current price, Paragon’s shares appear attractively valued from a long-term standpoint, given its recent growth, high profitability metrics and the pricing multiples. (Investors should keep in mind that liquidity is limited in the stock.)

Net income for the first quarter of 2016 was \$2.8 million, or \$0.62 per diluted share, up 23% (22% on a per share basis) from \$2.3 million, or \$0.51 per diluted share, in 2015’s first quarter. We had projected earnings would be \$0.69 per share. Relative to the year-ago figures, the improvement in earnings was mainly driven by strong growth in net interest income, which increased 12% to \$10.6 million in 2016’s first quarter from \$9.5 million in the year-ago quarter. The net interest margin has been inching up for several quarters, and was 3.54% in 2016’s first quarter, versus 3.48% in 2015’s first quarter, although it was mainly the double digit growth in average earning assets that led to the net interest income strength. Core noninterest income was essentially unchanged from the year-ago quarter. Excluding gains on the sale of securities and losses on the sale of OREO, noninterest income

ASSETS: \$1.3 BB

HQ: RALEIGH, NC

CONTACT:
BOB C. HATLEY
(919) 788-7770

1ST QUARTER HIGHLIGHTS:

EARNINGS INCREASED SHARPLY, AND BALANCE SHEET GROWTH AND ASSET QUALITY WERE GOOD

EPS: \$0.62 vs. \$0.51

NET INTEREST INCOME WAS UP 12%, MAINLY DUE TO HIGHER AVERAGE EARNING ASSETS

CORE NONINTEREST INCOME WAS ESSENTIALLY UNCHANGED

**NONINTEREST EXPENSE
INCREASED 12%**

**LOAN GROWTH REMAINED
GOOD, BOTH RELATIVE TO THE
YEAR-AGO LEVEL AND THE END
OF 2015**

**PARAGON'S STOCK HAS BEEN AN
EXCELLENT LONG-TERM
PERFORMER**

**THE SHARES HAVE
APPRECIATED MORE THAN 10%
ANNUALLY SINCE THE COMPANY
BEGAN IN 1999**

**THE MORE RECENT RETURNS
HAVE BEEN QUITE STRONG AS
WELL**

**THE SHARES APPEAR
ATTRACTIVELY VALUED BASED
ON ITS PERFORMANCE AND
VALUATION MULTIPLES**

NPAS/ASSETS: 0.43%

**PARAGON HAS ALMOST NO
NONACCRUING LOANS**

RESERVES/LOANS: 0.76%

**EPS:
2014A: \$ 1.77
2015A: \$ 2.47
2016E: \$ 2.66**

was \$393,000, versus \$398,000 in 2015's first quarter. Noninterest expense was \$6.6 million in the first quarter of 2016, largely due to additional key hires, up from \$5.9 million in the first quarter of 2015. Earnings also benefitted from the fact that there was no provision for loan losses in 2016's first quarter, whereas there was a \$571,000 provision in the year-ago quarter.

Balance sheet growth is also holding up well. Loan origination activity is benefitting from several new commercial lending hires at the Bank, and are part of the reason that gross loans increased 11% to \$1,045,000 at March 31, 2016 from \$944,000 at the year-ago date. Assets increased 6% over the same period, while deposits, which continued to experience a favorable shift away from Internet and brokered deposits to local funding, grew 10%. Capitalization ratios remain solid as well, as the equity-to-assets ratio was 7.47% at March 31, 2016, and all of the Bank's regulatory capital ratios exceed "well capitalized" minimums.

Stock Performance and Relative Valuation

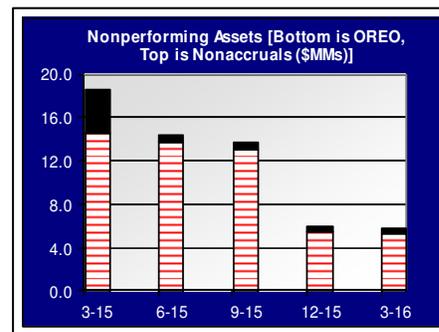
Paragon has done an outstanding job of building shareholder value over time. The Company originally issued stock at a price of \$52,500 per share in 1999. Since that time, there have been five stock splits/dividends, the result of which is that each original share is now equal to 10,000 shares. Based on the current price of \$27.20, that equates to a current value of \$272,000, or an annual rate of return of over 10%. The S&P 500's return over the same time period was less than half that amount, and the NASDAQ Bank return was even lower. While the long-term return has been quite impressive, so have the more recent returns. Over the past year, Paragon's stock is up 17%, while it increased at a 20% annual rate over the

Relative Stock Performance			
Approximate Dates	Annualized Returns		
	Paragon	S&P 500	NASDAQ Bank
One Year	17.0%	-0.8%	0.0%
Three Year	45.7%	10.5%	8.4%
Five Year	20.0%	11.1%	8.8%
Since Inception (May 1999)	10.2%	4.6%	2.2%

past five years. All of these return measures significantly exceed those of the other indices. Despite the fact that Paragon Commercial's stock has appreciated significantly over these periods, the shares appear to be quite reasonably priced at today's valuation, based the multiples of book value, earnings, and the Company's performance. One of the metrics we often consider when comparing banks is the ratio of the ROAE divided by the stock price's multiple of book value, which effectively produces a "return on the market value of equity." Higher figures, all else being equal, are obviously more attractive for purchase than lower ones. If we take Paragon's most recent ROAE of 11.46% and divide it by its market to book value ratio of 1.24x, we arrive at a return on the market value of equity of 9.24%. The median comparable ratio for Southeast publicly traded banks 6.8%, and for North Carolina publicly traded banks, is about 6.4%.

Asset Quality Remains Excellent

As of March 31, 2016, nonperforming assets were \$5.7 million, or 0.43% of assets, versus \$6.0 million, or 0.46% of assets, at year-end 2015 and \$18.5 million, or 1.46% of total assets, at March 31, 2015. As can be seen in the adjacent chart, Paragon has almost no nonaccruing loans. The allowance for loan losses was \$7.9 million (0.76% of gross loans) at March 31, 2016, versus \$7.6 million (0.80% of gross loans) at the year-ago date.



Projections Lowered

Based on the most recent results, we are lowering our earnings projection for 2016 to \$12.2 million, or \$2.66 per diluted share, from our previous estimate of \$12.9 million, or \$2.82 per diluted share. These projections could vary widely depending on changing conditions.

ADDITIONAL INFORMATION UPON REQUEST

Copyright © 2016 Equity Research Services, Inc. All rights reserved. This material is for your information only and is not a solicitation, or an offer, to buy or sell securities mentioned. Equity Research Services, Inc. ("ERS") is a firm involved in financial advisory, equity research, valuation and investor relations services. All reports generated by ERS for the purpose of investor relations are designated "Investor Relations Report," and ERS receives a fee (from the company whose securities are described) for producing such reports. ERS may also act in a financial advisory role to the company. The information contained herein has been obtained from sources we believe reliable but in no way is guaranteed by us. Furthermore, this report contains forward-looking statements and projections that are based on certain assumptions and expectations. Accordingly, actual results may differ considerably from those reflected in this report due to such factors as those which are listed in the Company's SEC or other filings. Any non-factual information in the report is our opinion and is subject to change without notice.