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## Paragon Commercial Corporation (NASDAQ - PBNC)

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North Carolina  
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**John A. (Buddy) Howard, CFA**  
**August 6, 2016**

<b>Price:</b>	\$36.29	<b>EPS *</b>	<b>2014A:</b>	\$ 1.77	<b>P/E</b>	<b>2014A:</b>	20.5x
<b>52 Wk. Range:</b>	\$21.00 - \$38.73	(FY: DEC)	<b>2015A:</b>	\$ 2.47		<b>2015A:</b>	14.7x
<b>Div/Div Yld:</b>	\$0.00 / 0.0%		<b>2016E:</b>	\$ 2.66		<b>2016E:</b>	13.6x
<b>Shrs/Mkt Cap:</b>	5.4 mm / \$198 mm	<b>Book Value:</b>		\$ 24.17	<b>Price/Book Value:</b>		1.50x

\* Diluted.

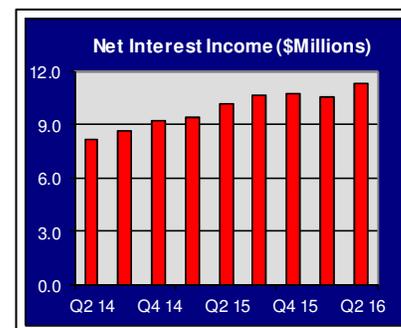
### Background

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 \$1.5 billion in assets as of June 30, 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 NASDAQ under the symbol “PBNC”.

### Second Quarter Results Were Excellent; IPO Completed

The second quarter of 2016 was one of the most significant ones in the Company’s history. The financial results were quite good, and were, in fact, a good deal better than expected. But more important than that, the Company successfully closed on its initial public offering, which not only generated roughly \$27 million of capital to support future growth but also created much better liquidity for shareholders and added institutional owners to the Company’s shareholder mix, all of which we view as favorable developments for shareholders. The offering, in fact, was oversubscribed, a testament to the market’s understanding of Paragon’s unique business model, as well as its confidence in management and great execution on the part of the underwriters. The offering was co- managed by Raymond James & Associates (the book running manager) and Sandler O’Neill & Partners, L.P. Raymond James has also initiated Research on the Company (report dated 7/20/16).

In terms of the quarterly results, net income for the second quarter of 2016 was \$3.5 million, or \$0.75 per diluted share, up 31% (27% on a per share basis) from \$2.7 million, or \$0.59 per diluted share, in 2015’s second quarter. Our estimate for EPS had been \$0.66, so the results were a full \$0.09 better than expected. The biggest driver of the earnings growth was net interest income, which had been somewhat flat on a linked quarter basis for a few quarters, but which rebounded nicely in the quarter. Specifically, net interest income increased 11% to \$11.3 million in 2016’s second quarter from \$10.2 million in the



**ASSETS: \$1.5 BB**

**HQ: RALEIGH, NC**

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**2<sup>ND</sup> QUARTER HIGHLIGHTS:**

**THE COMPANY’S IPO WAS COMPLETED, NETTING \$27 MILLION IN NEW CAPITAL**

**EPS: \$0.75 VS. \$0.59**

**EPS WAS ABOUT \$0.09 BETTER THAN WE HAD PROJECTED**

**EARNINGS MAINLY BENEFITTED FROM HIGHER NET INTEREST INCOME, WHICH INCREASED 11%**

**NET INTEREST INCOME BENEFITTED FROM A HIGHER MARGIN AND GROWTH IN AVERAGE EARNING ASSETS**

**NONINTEREST EXPENSE INCREASED A MODEST 1%**

**FIRST HALF HIGHLIGHTS:**

**EPS: \$1.37 vs. \$1.10**

**NET INTEREST INCOME WAS UP 11%**

**LOAN GROWTH HAS BEEN ACCELERATING, PARTLY DUE TO RECENT HIRES**

**OVER THE PAST YEAR, LOANS INCREASED 12%, WHILE ASSETS WERE UP 11% AND DEPOSITS GREW 7%**

**THE ADDITIONAL CAPITAL HAS BOOSTED THE EQUITY-TO-ASSETS RATIO TO 9.1% FROM 6.9% OVER THE PAST YEAR**

**NPAS/ASSETS: 0.44%**

**NONACCRUING LOANS TO TOTAL LOANS ARE ONLY 0.11%**

**RESERVES/LOANS: 0.72%**

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

year-ago quarter. The net interest margin continued to move up, as it has been for the past few quarters, and was 3.55% in 2016's second quarter, versus 3.50% in the year-ago quarter, while average earning assets increased an impressive 10%. Excluding net losses on the sale of OREO, noninterest income was \$426,000, versus \$450,000 in 2015's second quarter. Expense containment was particularly impressive, as noninterest expense was only up 1% despite the double digit increase in the balance sheet and in net interest income. Finally, we would note that there was no provision for the second quarter of 2016, versus a provision of \$179,000 in the year-ago quarter. Given the Company's strong loan growth, we do expect the provision to increase in coming quarters.

For the first half of 2016, Paragon Commercial Corporation earned \$6.3 million, or \$1.37 per diluted share, versus \$5.0 million, or \$1.10 per diluted share, in the year-ago period. Net interest income increased 11%, noninterest income (excluding security gains and OREO write-downs) was down about 3% and noninterest expense was up 7% over this period. There was no provision for loan losses in the first half of 2016, versus a provision of \$750,000 for the first six months of 2015.

**Loan Growth Has Been Accelerating**

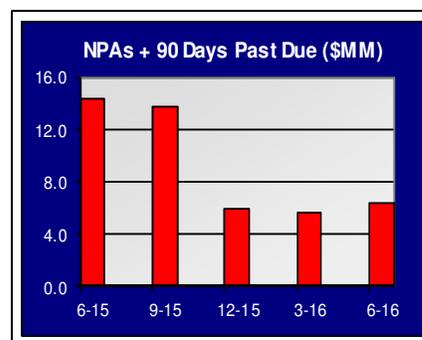
Loan origination activity has been brisk, partly due to recent commercial lender hires. As a result, loan growth has actually been picking up quite nicely over the past few quarters, as can be seen from the annualized growth (on a linked quarter basis) in the table below. Also shown are the favorable growth trends in other key balance sheet items, and the favorable impact that the offering proceeds had on the Company's capital ratio (equity to assets, though all of the regulatory ratios strengthened as well). One point we would note is that deposits did contract late in 2015, but that was an intentional move by management to obtain a more favorable mix of core deposits and

Balance Sheet Growth	Q2 15	Q3 15	Q4 15	Q1 16	Q2 16
Gross Loans (\$MM)	991	998	1,016	1,045	1,105
<b>Annualized Growth % - Linked Qtr</b>	<b>19.9%</b>	<b>2.8%</b>	<b>7.2%</b>	<b>11.4%</b>	<b>23.0%</b>
Assets	1,313	1,361	1,306	1,341	1,454
Deposits	1,025	1,056	983	1,047	1,100
Equity	91	94	98	100	132
<b>Equity/Assets</b>	<b>6.9%</b>	<b>6.9%</b>	<b>7.5%</b>	<b>7.5%</b>	<b>9.1%</b>

to allow higher cost deposits to roll off the books. From June 30, 2015 to June 30, 2016, gross loans increased 12%, while assets grew 11% and deposits increased 7%. Reflecting the proceeds from the offering, the Company's shareholders' equity totaled \$132 million, or 9.1% of assets, at June 30, 2016, as compared to \$91 million, or 6.9% of total assets, at the year-ago date. All of Paragon's regulatory capital ratios comfortably exceeded "well capitalized" minimums.

**Asset Quality Remains Excellent**

Paragon continues to have asset quality metrics that are much better than those of most North Carolina banks. Total nonperforming assets at June 30, 2016 were \$6.4 million, or 0.44% of total assets, up slightly from \$5.7 million, or 0.43% of total assets, at March 31, 2016, but down from \$14.4 million, or 1.10% of total assets, at June 30, 2015. More than three-fourths of NPAs are OREO. Nonaccruing loans were only 0.11% of total loans outstanding at June 30, 2016. The allowance for loan losses was \$8.0 million (0.72% of gross loans) at June 30, 2016, versus \$7.6 million (0.76% of gross loans) at the year-ago date.



**Projections Maintained**

Although earnings were better than expected, we are maintaining our earnings projection at \$13.3 million, or \$2.66 per diluted share. Our not increasing the EPS estimate is based, in part, on our belief that rapid loan growth could lead to pressure on the provision for loan losses.

**ADDITIONAL INFORMATION UPON REQUEST**

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