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## Paragon Commercial Corporation (NASDAQ - PBNC)

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**John A. (Buddy) Howard, CFA**  
February 11, 2017

<b>Price:</b>	\$47.09	<b>EPS *</b>	<b>2015A:</b>	\$ 2.47	<b>P/E</b>	<b>2015A:</b>	19.1x
<b>52 Wk. Range:</b>	\$26.40 - \$48.00	(FY: DEC)	<b>2016A:</b>	\$ 2.68		<b>2016A:</b>	17.6x
<b>Div/Div Yld:</b>	\$0.00 / 0.0%		<b>2017E:</b>	\$ 2.80		<b>2017E:</b>	16.8x
<b>Shares/Mkt Cap:</b>	5.4 mm / \$257 mm	<b>Book Value:</b>		\$ 24.97	<b>Price/Book Value:</b>		1.89x

\* 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 December 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 NASDAQ under the symbol “PBNC.”

### Fourth Quarter Results Were Excellent

Paragon Commercial Corporation had a solid fourth quarter, with earnings that came in slightly better than we had projected. Moreover, loan growth remained strong and asset quality continued to improve. Paragon’s stock price has also continued to reflect excellent strength, and management’s ability to build long-term shareholder value – through the successful execution of its highly efficient business model (Paragon’s efficiency ratio was 52.7% in the most recent quarter) – has been exemplary. Although the shares appear fairly valued at this point, we believe the long-term growth trajectory of the Company will be sufficiently high that longer term shareholders will be rewarded with solid returns, especially given management’s track record.

Net income for the fourth quarter of 2016 was \$3,622,000, or \$0.67 per diluted share, versus \$2,963,000, or \$0.65 per diluted share, in 2015’s fourth quarter. (We had projected EPS of \$0.65 per share, based on an expectation of a higher provision). While aggregate earnings increased 22%, the lower 3% growth in EPS resulted from the additional shares from the Company’s IPO in 2016’s second quarter. Net interest income was strong, growing 16% to \$12.4 million in 2016’s fourth quarter from \$10.7 million in the year-ago quarter, with margins improving slightly (the net interest margin was 3.58% in 2016’s fourth quarter, versus 3.52% in the year-ago quarter), as well as a strong (14%) increase in average earning assets. Excluding net losses on the sale of OREO and security gains, noninterest income increased roughly 52% to \$631,000 from \$415,000 in the year-ago quarter, while noninterest expense was up 11%. Finally, we would note that the earnings growth was achieved despite an increase in the provision for loan losses to \$200,000 in the fourth quarter of 2016, versus no provision in the year-ago quarter.

**ASSETS: \$1.5 BB**

**HQ: RALEIGH, NC**

**CONTACT:**  
**BOB C. HATLEY**  
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**4<sup>TH</sup> QUARTER HIGHLIGHTS:**

**EPS: \$0.67 vs. \$0.65**

**THE EARNINGS GROWTH WAS ACHIEVED DESPITE AN INCREASE IN THE PROVISION FOR LOAN LOSSES**

**NET INTEREST INCOME WAS UP AN IMPRESSIVE 16%**

**MARGINS AND AVERAGE EARNING ASSETS BOTH INCREASED**

**CORE NONINTEREST INCOME WAS UP 52%, WHILE NONINTEREST EXPENSE WAS UP 11%**

**FULL YEAR HIGHLIGHTS:**

**EPS: \$2.68 vs. \$2.47**

**LOAN GROWTH REMAINS EXCELLENT, AND HAS BEEN COMING FROM ALL THREE OFFICES**

**DEPOSIT GROWTH HAS LIKEWISE BEEN STRONG AND HAS MAINLY COME FROM CORE DEPOSITS**

**CAPITAL RATIOS REMAIN STRONG**

**PARAGON'S STOCK PERFORMANCE HAS BEEN EXCELLENT**

**THE RETURNS EXCEED COMMON STOCK INDICES FOR ALMOST ALL PERIODS CONSIDERED**

**EVEN IF AN INVESTOR SOMETIMES "OVERPAYS" FOR A STOCK, SOLID EARNINGS CAN EVENTUALLY "BAIL YOU OUT"**

**NPAs/ASSETS: 0.38%**

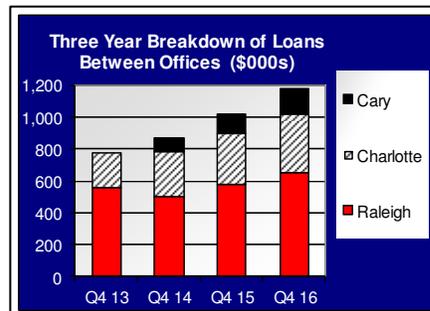
**RESERVES/LOANS: 0.66%**

**EPS:  
2015A: \$ 2.47  
2016A: \$ 2.66  
2017E: \$ 2.80**

For the full year of 2016, Paragon Commercial Corporation reported earnings of \$13.4 million, or \$2.68 per diluted share, versus \$11.2 million, or \$2.47 per diluted share, in 2015. Net interest income increased 12%, noninterest income (excluding security gains and OREO write-downs) was up 13% and noninterest expense was up 9% over this period.

**Balance Sheet Growth Has Come From All Offices**

Along with an unusually efficient operation, Paragon Commercial's ability to sustain loan and overall balance sheet growth has been one of its hallmarks. That growth has been quite consistent. In the past year (from December 31, 2015 to December 31, 2016), gross loans increased 17%, while assets grew 15% and deposits were up 19%. Moreover, the majority of that deposit growth was in noninterest-bearing demand deposits (up 33%) and money market accounts and interest-bearing checking accounts (up 47%), while time deposits decreased 31%. All of its locations have been contributing to this growth, as can be seen from the loan trends at each location over the past few years. The Company's capital position remains strong as well. Shareholders' equity totaled \$136 million, or 9.1% of assets, at December 31, 2016, as compared to \$98 million, or 7.5% of total assets, at the year-ago date.



**Paragon's Ability to Build Shareholder Value Has Been Exceptional**

Paragon 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 \$47.09, that equates to a current value of nearly \$471,000, or an annual rate of return of over 13%. The NASDAQ Bank's return over the same time period was roughly a third of that amount, and the S&P 500 return was even lower. Generally, Paragon's returns for other holding periods likewise compare favorably. The one period we considered where the returns were not as high was for the ten year period. In early 2007, Paragon's stock was actually changing hands (albeit on a very limited basis) at a whopping 4.5x book value, highlighting the fact that it is indeed possible to overpay for great companies. However, it is also a lesson that even if an investor occasionally "overpays," solid earnings growth can eventually offset that premium, as evidenced by the fact that even those investors who paid 4.5 times book value have essentially maintained their value over this period.

Approximate Dates	Relative Stock Performance		
	Annualized Returns		
	Paragon	S&P 500	NASDAQ Bank
One Year	74%	25%	56%
Three Year	71%	9%	16%
Five Year	34%	12%	17%
Ten Year	0%	5%	1%
Since Inception (May 1999)	13%	3%	4%

**Asset Quality Continues to Improve**

Total nonperforming assets at December 31, 2016 were \$5.7 million, or 0.38% of assets, versus \$6.1 million, or 0.41% of assets, at September 30, 2016 and \$6.0 million, or 0.46% of total assets, at December 31, 2015. Nonaccruing loans were only 0.04% of total loans outstanding at December 31, 2016. The allowance for loan losses was \$7.9 million (0.66% of gross loans) at December 31, 2016, versus \$7.6 million (0.75% of gross loans) at the year-ago date.

**Projections Increased**

We are slightly increasing our 2017 earnings projection to \$15.2 million, or \$2.80 per diluted share, up from \$15.0 million, or \$2.75 per diluted share previously. We believe these projections may be slightly conservative.

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