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Paragon Commercial Corporation (NASDAQ - PBNC)

5003 Falls of Neuse Road

Raleigh
North Carolina
27609

919-876-8868 ph

www.equityresearch.com

John A. (Buddy) Howard, CFA
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Price:	\$52.23	EPS *	2015A:	\$ 2.47	P/E	2015A:	21.1x
52 Wk. Range:	\$27.20 - \$57.05	(FY: DEC)	2016A:	\$ 2.68		2016A:	19.5x
Div/Div Yld:	\$0.00 / 0.0%		2017E:	\$ 2.80		2017E:	18.7x
Shares/Mkt Cap:	5.5 mm / \$285 mm	Book Value:		\$ 25.70	Price/Book Value:		2.03x

* 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 \$1.6 billion in assets as of March 31, 2017, 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.” As is discussed in more detail below, the Company recently agreed to be acquired by TowneBank (NASDAQ: TOWN).

First Quarter Results Reflected Solid Earnings Growth; EPS Affected by Additional Shares

Paragon Commercial Corporation reported another solid quarter. Earnings posted an 18% increase from the year-ago numbers, though earnings were flat on a per share basis due to the additional shares from the Company’s IPO in the second quarter of 2016. Most of the fundamentals were positive, as they have been for some time. That record of success finally caught the attention of some large institutions: after quarter end, Paragon made the surprise announcement that it had agreed to be sold to TowneBank, an \$8 billion bank that is based in Portsmouth, VA.

Looking first at the financial results, net income for the first quarter of 2017 was \$3,354,000, or \$0.62 per diluted share, versus \$2,838,000, or \$0.62 per diluted share, in 2016’s first quarter. (We had projected EPS of \$0.64 per share.) Strong momentum remained evident in net interest income, which grew 17% to \$12.3 million in 2017’s first quarter from \$10.6 million in the year-ago quarter, with margins dropping about ten basis points from the year-ago figures (3.44% versus 3.54%). That margin decline, however, was more than offset by the strong increase in average earning assets, which grew 21% over the period. Excluding net losses on the sale of OREO and security gains in the year-ago quarter, noninterest income increased 28% to \$503,000, up from \$393,000 in the year-ago quarter, with a good deal of that growth due to an increase in the cash surrender value of life insurance owned by the Company. Noninterest expense was up 15%, which was a bit higher than is typical, reflecting several recent hires in key lending areas, as well as additional costs for cyber-security enhancements. Finally, the provision for loan losses increased in 2017’s first quarter to \$159,000, versus no provision in the year-ago quarter.

ASSETS: \$1.6 BB

HQ: RALEIGH, NC

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

1ST QUARTER HIGHLIGHTS:

PARAGON HAS ANNOUNCED IT IS SELLING TO TOWNEBANK

EPS: \$0.62 vs. \$0.62

AGGREGATE EARNINGS INCREASED 18%, ALTHOUGH THE ADDITIONAL SHARES FROM THE IPO TEMPERED THE PER SHARE INCREASE

NET INTEREST INCOME WAS UP AN IMPRESSIVE 17%, WHILE CORE NONINTEREST INCOME GREW 28%

Balance Sheet Growth Remained Strong

Paragon continues to experience excellent balance sheet growth. In the past three months alone, Paragon booked roughly \$40 million in new loans, *net of pay offs*, which represents an annualized growth rate of more than 13%. (Growth relative to the year-ago level was 18%.) Deposit growth was similarly strong, as total deposits increased 21% over the past year, with the most pronounced growth in noninterest-bearing demand deposits (up 34% over the past year) and money market accounts and interest-bearing checking accounts (up 36% over the past year). Shareholders' equity at March 31, 2017 was \$140 million, or 9.0% of assets, as compared to \$100 million, or 7.5% of total assets, at the year-ago date.

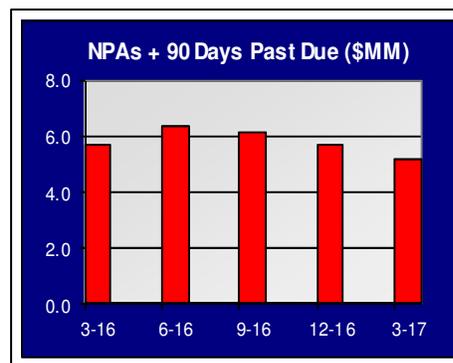
Paragon Agrees to Sell to TowneBank

As was mentioned at the beginning of the report, the most notable recent development was the Company's announcement on April 27, 2017 that it had agreed to be sold in an all-stock transaction to TowneBank, a Portsmouth, VA based bank with more than \$8 billion in assets. The transaction is expected to close in 2017's fourth quarter. Under the terms of the agreement, each Paragon shareholder will receive 1.7250 shares of TowneBank for each share of Paragon owned. Based on the price of TowneBank on the date of the announcement, that exchange ratio equates to a price of \$59.25 per share. (Based on the price of TowneBank as of the date of this report, the implied value is \$52.61 per share.) TowneBank has been a rapidly growing and profitable bank that has expanded both organically and through acquisition. Its assets have grown 28% in the past year, its net loans were up 32%, and deposits grew 25%. Its ROAE over the past 12 months was 7.4%, and it has a tangible equity to tangible assets ratio of 10.0%. Moreover, based on our discussions with Paragon's management, the two banks are a good cultural fit. Even at the lower current valuation of TowneBank, and the implied deal value of \$52.61, the transaction would represent a strong record of appreciation for Paragon's original investors. Based on the original offering price of \$52,500 for a single share in 1999, that one share is now equal to 10,000 shares, which equates to an equivalent original price of \$5.25 per share. Stated differently, original investors have had a more than tenfold increase in their original investment, and that original investment, if held until today, would be worth more than a half million dollars.

Paragon Commercial Corp. Stock Split Summary				
	Date	Split Factor	Adjusted # of Shares	Adjusted Price
Original Share	05/10/99		1	52,500.00
10 for 1 Split	07/01/02	10	10	5,250.00
2 for 1 Split	07/01/03	2	20	2,625.00
2 for 1 Split	01/31/05	2	40	1,312.50
2 for 1 Split	12/31/05	2	80	656.25
125 for 1 Split	06/23/14	125	10,000	5.25

Asset Quality Continues to Improve

Total nonperforming assets at March 31, 2017 were \$5.2 million, or 0.34% of assets, versus \$5.7 million, or 0.38% of assets, at December 31, 2016 and \$5.7 million, or 0.43% of total assets, at March 31, 2016. Nonaccruing loans were only 0.04% of total loans outstanding at March 31, 2017. The allowance for loan losses was \$8.1 million (0.66% of gross loans) at March 31, 2017, versus \$7.9 million (0.76% of gross loans) at the year-ago date.



Projections Maintained

We are maintaining our 2017 earnings projection at \$15.2 million, or \$2.80 per diluted share. We believe these projections may be slightly conservative.

ADDITIONAL INFORMATION UPON REQUEST

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GROSS LOANS GREW ROUGHLY \$40 MILLION IN THE LAST THREE MONTHS, NET OF PAY OFFS

KEY BALANCE SHEET ITEM GROWTH RATES WERE GENERALLY IN THE 15% TO 20% RANGE

PARAGON IS SELLING TO TOWNEBANK IN AN ALL-STOCK TRANSACTION

EACH SHARE OF PARAGON WILL BE EXCHANGED FOR 1.725 SHARES OF TOWNEBANK STOCK

BASED ON THE CURRENT PRICE OF TOWNEBANK, ORIGINAL PARAGON INVESTORS HAVE RECEIVED MORE THAN TEN-FOLD INCREASE IN VALUE

THE TRANSACTION IS EXPECTED TO CLOSE IN THE FOURTH QUARTER OF 2017

ASSET QUALITY REMAINS EXCELLENT

NPAs/ASSETS: 0.34%

RESERVES/LOANS: 0.66%

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