

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

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
November 11, 2016

Price:	\$37.61	EPS *	2015A:	\$ 2.47	P/E	2015A:	15.2x
52 Wk. Range:	\$25.50 - \$39.99	(FY: DEC)	2016E:	\$ 2.66		2016E:	14.1x
Div/Div Yld:	\$0.00 / 0.0%		2017E:	\$ 2.75		2017E:	13.7x
Shrs/Mkt Cap:	5.4 mm / \$205 mm	Book Value:		\$ 24.77	Price/Book Value:		1.52x

* 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 September 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.”

Third Quarter Results Were In Line With Expectations

Paragon Commercial Corporation reported third quarter earnings that were slightly below our projections but, on an operating basis, were actually better than we had modeled. The earnings per share comparisons were affected by the additional shares from the Company’s initial public offering, which was completed in June 2016. Those additional shares in 2016’s third quarter led to a drop in EPS, although aggregate earnings actually improved from the year-ago figures. Moreover, there were nonrecurring gains in the year-ago quarter (and none in 2016’s third quarter), and a higher provision in 2016’s third quarter (it increased due to rapid loan growth, as opposed to loan degradation), the net result being that normalized earnings were actually stronger than stated earnings. Finally, we would note that we were quite impressed with loan growth, which continues to advance at double digit rates. We were also impressed that nearly every category of loan (commercial real estate, commercial and industrial, consumer real estate and construction and development, etc.) increased from the year-ago level, so the growth was broad based.

In terms of the specific results, net income for the third quarter of 2016 was \$3,455,000, or \$0.64 per diluted share, versus \$3,313,000, or \$0.73 per diluted share, in 2015’s third quarter. Although the increase in aggregate earnings was about 4%, pretax income before the provision for loan losses and security gains was closer to 11%, which was more in line with what we had expected. The largest driver of the improving core earnings was net interest income, which has benefitted

Quarterly Results (\$000s)	Q3 2015	Q3 2016
Net Income	3,313	3,455
Pretax Income	5,020	5,036
Add back provision	-	391
Deduct Security Gains	(145)	-
Pretax Bef. Nonrec. Items	4,875	5,427

ASSETS: \$1.5 BB

HQ: RALEIGH, NC

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

3RD QUARTER HIGHLIGHTS:

EPS: \$0.64 vs. \$0.73

**EPS COMPARISONS WERE
AFFECTED BY THE
ADDITIONAL SHARES FROM
THE IPO**

**PRETAX INCOME BEFORE THE
PROVISION AND SECURITY
GAINS WAS UP 11%**

**NET INTEREST INCOME WAS
STRONG AND INCREASED 10%**

CORE NONINTEREST INCOME WAS ESSENTIALLY FLAT AND NONINTEREST EXPENSES WERE UP 10%

PARAGON'S EFFICIENCY RATIO WAS 54% IN THE MOST RECENT QUARTER, THE THIRD BEST FIGURE AMONG 31 PUBLIC BANKS IN NC

FIRST NINE MONTHS:

EPS: \$2.00 vs. \$1.82

NET INTEREST INCOME WAS UP 11%

LOANS CONTINUE TO LEAD THE BALANCE SHEET GROWTH, AND WERE UP 17% FROM THE YEAR-AGO DATE

DEPOSIT GROWTH WAS EXCELLENT AS WELL, WITH NOTABLE PROGRESS BUILDING LOW COST CORE DEPOSITS

THE CAPITAL RATIO REMAINS QUITE STRONG, AND CAN SUPPORT THE BANK'S ONGOING GROWTH

NPAs/ASSETS: 0.41%

NONACCRUING LOANS TO TOTAL LOANS DROPPED TO 0.08%

RESERVES/LOANS: 0.68%

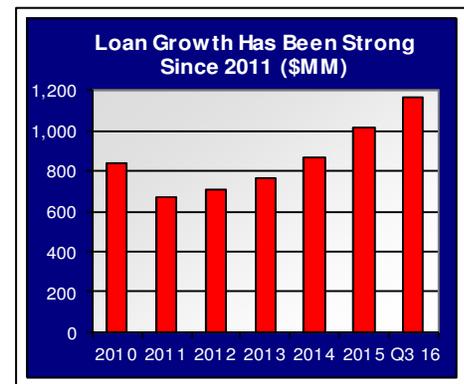
EPS:
2015A: \$ 2.47
2016A: \$ 2.66
2017E: \$ 2.75

principally from rapid average earning asset growth. Net interest income was \$11.8 million in 2016's third quarter, up 10% from \$10.7 million in the year-ago quarter. Margins have been holding steady, with modest pressure on asset yields being offset by a drop in funding costs from strong core deposit growth. Excluding net losses on the sale of OREO and security gains, noninterest income increased roughly 7% to \$438,000, while noninterest expense was up 10%, reflecting key hires over the past year, as well as the expenses (legal, audit, printing, etc.) associated with going public. (Despite the increase in expenses, Paragon Commercial's efficiency ratio was 54.4% in the most recent quarter, the third best out of 31 publicly traded banks in NC.) Finally, we would note that there was a provision for loan losses of \$391,000 in the third quarter of 2016, versus no provision in the year-ago quarter.

For the first nine months of 2016, Paragon Commercial Corporation reported earnings of \$9.8 million, or \$2.00 per diluted share, versus \$8.3 million, or \$1.82 per diluted share, in the year-ago period. Net interest income increased 11%, noninterest income (excluding security gains and OREO write-downs) was essentially unchanged and noninterest expense was up 8% over this period.

Loan Growth Continues to Propel the Balance Sheet

We follow a number of banks that occasionally have spurts of growth in the loan portfolio. However, in Paragon Commercial's case, it is the ability to *sustain* that loan growth that bodes well for long-term shareholder value, at least in our view. The 2011 drop in the loan portfolio occurred as the Company was reducing its risk-based assets and working through problem credits, but since that time, loans have increased each year by an average of about 12%. Recent momentum has been even stronger. Gross loans at September 30, 2016 were \$1.2 billion, up 17% from the year-ago level of \$1.0 billion. Also noteworthy is the increase in core deposits, as was mentioned earlier. Noninterest bearing deposits increased 16% to \$188 million over the past year, while money market accounts and interest checking accounts grew 53% to \$767 million, and time deposits (the most expensive) dropped 38% to \$244 million. The Company's capital position remains strong as well. Shareholders' equity totaled \$135 million, or 9.1% of assets, at September 30, 2016, as compared to \$94 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 and Has Been Stable on a Linked Quarter Basis

Asset quality metrics remain quite good. Total nonperforming assets at September 30, 2016 were \$6.1 million, or 0.41% of assets, versus \$6.4 million, or 0.44% of total assets, at June 30, 2016 and \$13.8 million, or 1.01% of total assets, at September 30, 2015. Roughly 84% NPAs are OREO, and nonaccruing loans were only 0.08% of total loans outstanding at September 30, 2016. The allowance for loan losses was \$7.9 million (0.68% of gross loans) at September 30, 2016, versus \$7.6 million (0.76% of gross loans) at the year-ago date.

Projections Maintained

We are maintaining our earnings projection at \$13.3 million, or \$2.66 per diluted share, and are introducing our 2017 earnings projection at \$15.0 million, or \$2.75 per diluted share. One factor that is likely to restrain earnings growth in the coming year is the need to add to the provision for loans losses, not due to any anticipated degradation to loan quality, but to simply allow the allowance to keep pace with the growth in the loan portfolio. That should bode well for longer-term earnings, however.

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.