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## Paragon Commercial Corporation (NASDAQ - PBNC)

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<b>Price:</b>	\$53.48	<b>EPS *</b>	<b>2015A:</b>	\$ 2.47	<b>P/E</b>	<b>2015A:</b>	21.7x
<b>52 Wk. Range:</b>	\$35.70 - \$57.05	(FY: DEC)	<b>2016A:</b>	\$ 2.68		<b>2016A:</b>	20.0x
<b>Div/Div Yld:</b>	\$0.00 / 0.0%		<b>2017E:</b>	N/A		<b>2017E:</b>	N/A
<b>Shares/Mkt Cap:</b>	5.5 mm / \$292 mm	<b>Book Value:</b>		\$ 26.62	<b>Price/Book Value:</b>		2.01x

\* Diluted. Projections have been suspended given the pending merger with TowneBank.

### 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 June 30, 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." *The Company recently agreed to be acquired by TowneBank (NASDAQ: TOWN). The transaction is expected to close in 2017's fourth quarter.*

### Second Quarter Operating Results Were Impressive

Paragon Commercial Corporation reported better operating results than implied by the bottom line comparisons. During the second quarter of 2017, strong loan growth (as opposed to any slippage in loan quality) required an increase in the provision for loan losses, in addition to there being merger related expenses that affected 2017's reported second quarter earnings. If we eliminate those items, the resulting operating figures represented a nice increase from the year-ago numbers. Moreover, from a balance sheet standpoint, Paragon continues to do an exemplary job growing the loan portfolio. Finally, asset quality remained quite good, with nearly no nonaccrual loans and total NPAs (mainly OREO) well below recent levels.

Reported net income for the second quarter of 2017 was \$3,283,000, or \$0.61 per diluted share, versus \$3,475,000, or \$0.75 per diluted share, in 2016's second quarter. (We had projected EPS of \$0.68 per share.) As was mentioned above, reported earnings were affected by the higher provision for loan losses (which was \$650,000 in 2017's second quarter, versus none in the year-ago quarter) as well as merger-related expenses, which totaled \$368,000 in 2017's second quarter. Excluding both of those items, the pretax, pre-provision core earnings were \$6,023,000 in 2017's second quarter, an increase of 16% from \$5,194,000 in the year-ago quarter. As has been the case in recent quarters, net interest income was the principal driver of the operating earnings growth. Specifically, net interest income

Second Quarter Results (\$000s)	2016	2017
<b>Net Income</b>	<b>3,475</b>	<b>3,283</b>
Pretax Income	5,194	5,005
Add Back:		
Provision	-	650
Merger Related Charges	-	368
<b>Pretax Inc. Bef. Nonrec. &amp; Prov.</b>	<b>5,194</b>	<b>6,023</b>

ASSETS: \$1.6 BB

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

OPERATING RESULTS WERE  
ACTUALLY BETTER THAN  
IMPLIED BY THE BOTTOM  
LINE RESULTS

EPS: \$0.61 vs. \$0.75

ALTHOUGH REPORTED  
EARNINGS WERE DOWN,  
PRETAX, PRE-PROVISION  
CORE EARNINGS WERE UP  
16%

NET INTEREST INCOME WAS  
UP 15%

**CORE NONINTEREST INCOME GREW 16%, WHILE NONINTEREST EXPENSE, EXCLUDING MERGER-RELATED EXPENSES, WAS UP 15%**

grew 15% to \$13.0 million in 2017's second quarter from \$11.3 million in the year-ago quarter, with margins dropping about four basis points from the year-ago figures (3.51% versus 3.55%), but average earning assets increasing about 17%. Trends in noninterest income were also favorable, as core noninterest income (excluding a loss on foreclosed property in the year-ago quarter) increased 16% to \$494,000, up from \$426,000 in the year-ago quarter. Finally, noninterest expense was up 21%, although the increase was only 15% (quite reasonable given Paragon's growth) if we exclude the previously mentioned merger-related expenses. Much of this increase relates to new lenders who have been hired, as well as cyber-security enhancements over the past year.

**FIRST HALF HIGHLIGHTS:**

**EPS: \$1.23 vs. \$1.37**

**LOANS GREW \$109 MILLION IN THE PAST THREE MONTHS**

**LOAN GROWTH OVER THE PAST YEAR WAS 21%**

For the first half of 2017, Paragon Commercial Corporation earned \$6,637,000, or \$1.23 per diluted share, up from \$6,313,000, or \$1.37 per diluted share, in the year-ago period. Net interest income increased 16%, noninterest income (excluding security gains and OREO write-downs) was up about 22% and noninterest expense was up 18% over this period. The provision for loan losses was \$809,000 in 2017's first half, versus none in the first half of 2016. As was stated earlier, balance sheet growth also remained strong. Loan growth, in particular, has been impressive, as Paragon added \$109 million in loans in the past three months alone, bringing the total over the past year to \$235 million. That is much more rapid than other NC Banks. Annual growth rates in loans (from June 30, 2016 to June 30, 2017) were 21%, while assets grew 12% and deposits increased 7% over the same period.

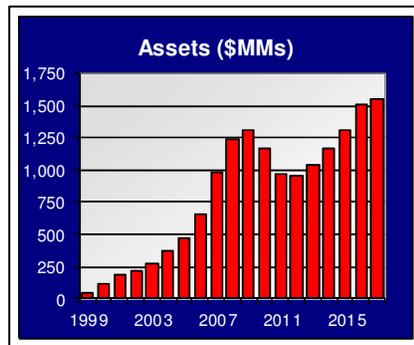
**One of Paragon's Greatest Strengths Has Been its Ability to Adjust the "Throttle" of Growth**

As Paragon nears the conclusion of its history as an independent bank, many investors will look back at it as a great growth story, where a group of investors and executives perceived an opportunity for a business bank and executed on that strategy with quite impressive results. The long-term rates of growth speak for themselves, not only in terms of the balance sheet and earnings buildup but also in the overall value of the investment. What many people may overlook, though, and which in some

**PARAGON HAS BEEN A GREAT GROWTH STORY....**

**...BUT JUST AS GREAT WAS ITS ABILITY TO PIVOT DURING AND AFTER THE CREDIT CRISIS....**

**...WHICH ALLOWED IT TO MITIGATE RISKS AND PRESERVE CAPITAL RATIOS**



ways was no less important, was the skill with which the management team *shrunk* the balance sheet. During the financial crisis of 2008 and in the ensuing years, the degradation in asset quality put tremendous strains on capital ratios and greatly increased the risk of insolvency for many institutions. Controlling that risk for banks like Paragon was not only a matter of managing problem credits; it was also "right sizing" the balance sheet so that the risk was managed. One of the most striking aspects about Paragon's performance was the speed with which it made these adjustments. At year-end 2009, its assets were \$1.3 billion; two years later, total assets were \$965 million, a drop of

26%. That bolstered all of the Company's capital ratios and established a baseline from which growth subsequently resumed. It only took until 2015 for the asset base to be restored to the 2009 level.

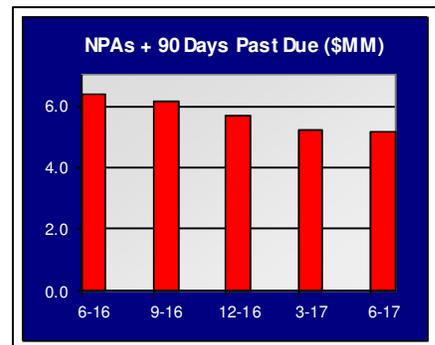
**ASSET QUALITY IS EXCELLENT**

**NPAs/ASSETS: 0.32%**

**RESERVES/LOANS: 0.67%**

**Asset Quality Remains Excellent**

Total nonperforming assets at June 30, 2017 were \$5.2 million, or 0.32% of assets, versus \$5.2 million, or 0.34% of assets, at March 31, 2017 and \$6.4 million, or 0.44% of total assets, at June 30, 2016. Nonaccruing loans were only 0.04% of total loans outstanding at June 30, 2017. The allowance for loan losses was \$8.9 million (0.67% of gross loans) at June 30, 2017, versus \$8.0 million (0.72% of gross loans) at the year-ago date.



**Projections**

We are suspending our earnings projection based on the pending merger with Towne Bank.

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