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Paragon Commercial Corporation (No Formal Market)

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Price: *	\$9.40	EPS **	2012A:	\$ 0.72	P/E	2012A:	13.1x
52 Wk. Range:	\$7.20 - \$9.40	(FY: DEC)	2013A:	\$ 1.11		2013A:	8.5x
Div/Div Yld:	\$0.00 / 0.0%		2014E:	\$ 1.75		2014E:	5.4x
Shrs/Mkt Cap:	4.4 mm / \$42 mm	Book Value:		\$ 18.60	Price/Book Value:		0.51x

* Limited trading. Price is most recent of which Company is aware. Per share figures are adjusted for 125 for 1 stock split paid June 23, 2014 ** 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 \$1.1 billion in assets as of June 30, 2014, the Bank focuses on business banking and private banking. The Bank conducts operations through locations in Raleigh, NC and Charlotte, 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.

Second Quarter Earnings Were Exceptional

Paragon Commercial Corporation reported excellent results in the second quarter of 2014. From a pure operating performance, nearly all of the key earnings drivers were favorably aligned: net interest income benefitted from earning asset growth and year-over-year margin expansion, noninterest income increased due to a large drop in real estate write-downs, and the provision was eliminated in the quarter due to the ongoing progress in asset quality. At the same time, balance sheet momentum was quite good, with the Bank building its base of core deposits and achieving upper single digit growth in loans. As positive as all of that was, one of the most significant events from a shareholder standpoint was the Board's decision to split the stock and to take steps for the shares to become listed on an exchange or be quoted on a bulletin board. Paragon's stock price has been trading in private market transactions at a steep discount to book value, much of which we attribute to its lack of marketability. Both the split and the move to become listed represent major initiatives to improve liquidity, which we believe may lead to an upward valuation of the shares, especially given Paragon's favorable fundamentals. Bottom line, we don't know when the outlook for the stock price has been any better.

Net income in 2014's second quarter was \$2.2 million, or \$0.49 per diluted share, up from \$0.5 million, or \$0.12 per diluted share, in 2013's second quarter. Those 2014 figures were well above our projections, as we had estimated a split-adjusted EPS figure of \$0.37 per share. Net interest income was strong, increasing 11% to \$8.2 million in 2014's second quarter from \$7.4 million in the year-ago quarter. Paragon is getting good loan production out of both its Raleigh and Charlotte offices, which has led to solid earning asset growth. This progress, combined with higher margins (3.49% in 2014's second quarter, versus 3.29% in the year-ago quarter) led to the Company achieving an all-time high in net interest income. While comparisons in net interest income should remain positive, we expect a

ASSETS: \$1.1 B

HQ: RALEIGH, NC

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2ND QUARTER HIGHLIGHTS:

EPS: \$0.49 VS. \$0.12

**MARGINS REMAIN WELL
ABOVE THE YEAR-AGO
FIGURES BUT HAVE
STABILIZED ON A LINKED
QUARTER BASIS**

NET INTEREST MARGIN:
3.49% IN Q2 2014 VS 3.29%
IN Q2 2013

**BASED ON THE MARGIN
IMPROVEMENT AND EARNING
ASSET GROWTH, NET
INTEREST INCOME INCREASED
11%**

**NONINTEREST INCOME
INCREASED ON A LINKED
QUARTER BASIS**

**NONINTEREST EXPENSE
INCREASED 18% FROM THE
YEAR-AGO QUARTER, THOUGH A
GOOD DEAL OF THIS WAS DUE TO
KEY HIRES**

FIRST HALF HIGHLIGHTS:

EPS: \$0.84 vs. \$0.31

**BALANCE SHEET OVER THE PAST
YEAR HAS BEEN GOOD,
ESPECIALLY IN TERMS OF CORE
DEPOSITS**

**LIQUIDITY IS GREATLY
IMPROVING IN THE STOCK PRICE**

**WE BELIEVE THE OUTLOOK FOR
A HIGHER PRICE IS QUITE
POSITIVE, PARTICULARLY GIVEN
MANAGEMENT'S AGGRESSIVE
GROWTH PLANS**

NPAs/ASSETS: 1.57%

**TRENDS ARE ALSO POSITIVE IN
30- TO 89-DAYS PAST DUE LOANS**

RESERVES/LOANS: 0.87%

**EPS:
2012A: \$ 0.72
2013A: \$ 1.11
2014E: \$ 1.75**

slight moderation in the rate of increase (for the past four quarters, the year-over-year increases have been: +30%, +16%, +15% and +11%). Earnings also benefitted from the absence of a provision for loan losses in 2014's second quarter, versus \$700,000 in the year-ago quarter. Another encouraging aspect of 2014's second quarter performance was that noninterest income was \$240,000, versus a loss of \$1,307,000 in the year-ago quarter, the key difference being that net losses on the sale of real estate dropped to only \$115,000 from \$1,749,000 over those periods. Finally, noninterest expense was up 18% to \$5.5 million in the second quarter of 2014 from \$4.6 million in the year-ago quarter, with most of that increase due to staffing additions. Clearly, the Company's ability to expand its balance sheet will be enhanced by identifying new lenders and other key executives with their own relationships.

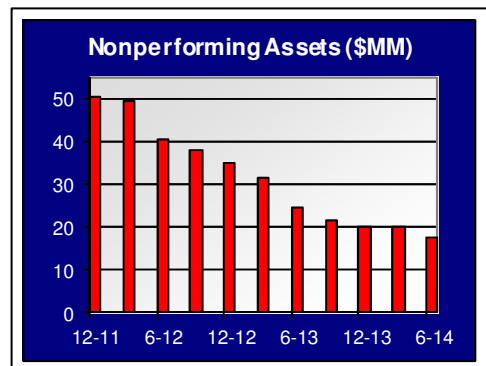
Six month results were also quite impressive, with net income of \$3,729,000, or \$0.84 per diluted share, in the first half of 2014, up from \$1,371,000, or \$0.31 per diluted share, in the year-ago period. As was the case with the quarterly results, earnings benefitted from higher net interest income, a lower provision and increased noninterest income. We were also encouraged by balance sheet growth. From June 30, 2013 to June 30, 2014, gross loans were up 8%, while assets grew 10% and deposits increased 14%. Core deposits (excluding brokered deposits, Internet deposits and CDARs) increased 45% and grew from 47% of total deposits to 60% over this period. Shareholders' equity was \$82.6 million, or 7.45% of total assets, at June 30, 2014.

Update of Paragon Stock Becoming Listed

As we mentioned previously, Paragon is currently in the process of improving the liquidity of its stock, and the expectation is that the shares might be quoted on the OTC Bulletin Board within the next few months. We believe this could lead to a higher valuation for the stock. Moreover, management has articulated, and is successfully executing on, a strategy to aggressively grow loans over the next two years, funded by core deposits, and to further reduce brokered and internet deposits. It also is targeting an overhead ratio below 2% of assets and to achieve a 1% ROA. Those kinds of targets, along with the expected improvement in the marketability of the stock, position the stock for a strong advance in our view. Ultimately, management's goal is to be at least at the 75 percentile on key ratios against its peers.

Trends in Asset Quality Remain Encouraging; NPAs Better than Peers

NPAs at June 30, 2014 were \$17.4 million, or 1.57% of assets, versus \$19.8 million, or 1.86% of total assets, at March 31, 2014 and \$24.3 million, or 2.41% of total assets, at June 30, 2013. This level of NPAs to assets remains below the typical NC Bank and below Paragon's peer group. Nonaccrual loans dropped from \$10.6 million to \$1.2 million over this period, and 30- to 89-days past due loans also improved. The Bank had only two accruing past due loans (totaling \$107,000) at the end of the quarter, so we expect asset quality trends to remain quite good. The allowance for loan losses was \$7.0 million, or 0.87% of loans, at June 30, 2014, versus \$9.2 million, or 1.24% of gross loans, at June 30, 2013.



Projections Increased

Based on the strength of second quarter earnings, we are increasing our 2014 earnings projection to \$7.8 million, or \$1.75 per diluted share. These projections could vary widely depending on changing conditions. We will introduce our 2015 EPS estimate in our next report.

ADDITIONAL INFORMATION UPON REQUEST

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