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# Four Oaks Fincorp, Inc. (FOFN – OTC BB)

**John A. (Buddy) Howard, CFA**
**February 17, 2017**

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Price:** | $3.55 | **EPS*** | **2015A: *** | $0.11 | **P/E** | **2015A: *** | 32.3 x |
| **52 Wk. Range:** | $1.75 - $3.65 | (FY: DEC) | **2016A: *** | $0.11 | | **2016A: *** | 32.3x |
| **Div/Div Yld:** | $0.00 / 0.0% | | **2017E:** | $0.12 | | **2017E:** | 29.6x |
| **Shrs/Mkt Cap:** | 33.8 mm / $120 mm | **Book Value:** | | $ 2.01 | **Price/Book Value:** | | 1.77 x |

* Excludes recovery of deferred tax asset. EPS in 2016 is fully taxed, whereas 2015 EPS is largely untaxed.

SYMBOL: FOFN

TOTAL ASSETS: $720 MM

HQ: FOUR OAKS, NC

CONTACT:
DAVID RUPP, CEO
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## Background

Four Oaks Fincorp, Inc. is a Four Oaks, North Carolina-based, single bank holding company with approximately $720 million in assets as of December 31, 2016. Its bank subsidiary is Four Oaks Bank & Trust Company, a state-chartered bank, which was established in 1912. Four Oaks Bank & Trust conducts its operations through 15 locations in Clayton, Smithfield (2 offices), Four Oaks, Benson, Garner, Wallace, Fuquay-Varina, Holly Springs, Apex, Harrells, Dunn, Raleigh (2 offices) and Zebulon, NC. Two of those branches (one each in Raleigh and Apex) are loan production offices (LPO). These offices are located in Johnston, Wake, Duplin, Harnett and Sampson Counties. Both Johnston and Wake Counties have been experiencing strong growth over the past ten years and are expected to continue to do so. In 2016, Four Oaks made the decision to close its Southern Pines LPO in order to focus resources on the growth markets within its core footprint. Four Oaks is currently operating under a written agreement with the Federal Reserve.

4TH QUARTER HIGHLIGHTS:

FOURTH QUARTER COMPARISONS WERE AFFECTED BY A NUMBER OF NONRECURRING ITEMS

EPS: $0.13 VS. $0.02

THE STOCK IS UP 43% SINCE OUR LAST REPORT

1-FOR-5 REVERSE STOCK SPLIT WILL TAKE EFFECT MARCH 1

## Fourth Quarter Results Continued to Reflect Strength

Four Oaks Fincorp reported solid results in the fourth quarter of 2016. While a good portion of 2016's fourth quarter earnings were due to a favorable nonrecurring tax adjustment, normalized earnings still came in fairly close to what we had expected. Moreover, balance sheet growth was commendable and asset quality was much better than year-ago levels. Management also did an excellent job containing expenses, as evidenced by the fact that total noninterest expense dropped significantly in 2016's fourth quarter, even if we exclude nonrecurring items. Not surprisingly, the stock price has been performing quite well, and is up 43% from our last report dated November 19, 2016. Much of that strength we attribute to the Company's improving fundamentals, though it may also relate to the upcoming 1-for-5 reverse stock split which will take effect March 1. (The stock is expected to adjust upwards on that date, although the impact to a particular shareholder should theoretically be offset by a commensurate drop in the number of shares they own.) Bottom line, though, it was a good quarter.

| | 2015 | 2016 |
|---|---|---|
| **Quarterly Results ($000s)** | **Q4** | **Q4** |
| Pretax Income | 810 | 1,045 |
| Eliminate: | | |
| Gains on the Sale of Loans | (3,105) | (351) |
| One Time Retirement Costs | 900 | - |
| Prepayment Penalty FHLB | 2,089 | - |
| Indemnification Income | (97) | - |
| **Normalized Pretax Operating Income** | 597 | 694 |

Reported net income in 2016's fourth quarter was $4,207,000, or $0.13 per diluted share, versus $810,000, or $0.02 per diluted share, in the year-ago quarter. Earnings in both quarters included nonrecurring items. In the year-ago quarter, there were $3.1 million in gains on the sale of problem loans, $97,000 in indemnification income, a $2.1 million prepayment penalty on a FHLB borrowing, and $900,000 in one time retirement costs. In 2016's fourth quarter, there were $351,000 in gains on the sale of problem loans and a $3.2 million income tax benefit resulting from the reversal of substantially all remaining

**EARNINGS EXCLUDING NONRECURRING ITEMS WERE UP ABOUT 16%**

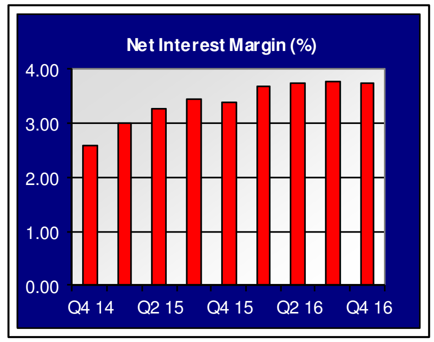
valuation allowances on deferred tax assets. If we exclude all of these items, pretax, "normalized" earnings were $694,000 in 2016's fourth quarter, up 16% from $597,000 in the year-ago quarter. Making that increase all the more impressive was the fact that foreclosed asset expenses (which tend to be somewhat volatile but which we did not add back as an adjustment) increased roughly $340,000 over the two periods.

**MARGINS HAVE BEEN HOLDING UP WELL**

**NET INTEREST INCOME INCREASED 11%, BENEFITTING FROM HIGHER MARGINS**

**EXPENSE CONTAINMENT WAS IMPRESSIVE, EVEN EXCLUDING NONRECURRING ITEMS**

Much of the increase in normalized earnings came from the increase in net interest income. Four Oaks Fincorp has made great strides in a number of areas over the past few years. One of those has been in improving margins. As can be seen in the adjacent chart, the net interest margin has increased from 2.58% in the fourth quarter of 2014 to 3.77% in the most recent quarter, which is better than the typical NC publicly traded bank. Obviously, the higher margins have contributed to the strength in net interest income, which increased a commendable 11% to $6,209,000 in 2016's fourth quarter from $5,596,000 in the year-ago quarter. Noninterest income excluding nonrecurring items, dropped to $1,335,000 in 2016's fourth quarter from $1,451,000 in the year-ago quarter. As was stated in our opening paragraphs, another major achievement of the quarter was expense control, as total noninterest expense dropped 27%, and excluding all nonrecurring items (retirement costs, prepayment penalties and foreclosure expense), was only up 1%.




## Full Year Results Were Also Commendable

**YEAR-TO-DATE HIGHLIGHTS:**

**PRETAX INCOME WAS UP 46%**

**LOANS INCREASED A HEALTHY 11% OVER THE PAST YEAR**

The full year results also included significant nonrecurring items. While net income for the full year was $6,858,000, or $0.21 per diluted share, for 2016, versus $20,008,000 for 2015, pretax income excluding nonrecurring items was $4,228,000 in 2016, versus $2,902,000, an increase of 46%. This represents a much more accurate reflection of the change in operating profitability than the bottom line figures suggested. Balance sheet growth was also commendable, with loans up 11% over the past year and deposits increasing 2% (non-time deposits were up 13%, as higher cost funds have been allowed to roll off the books). Shareholders' equity, which grew 13% over the past year, totaled $68.0 million, or 9.4% of total assets, at December 31, 2016. All of the Bank's regulatory capital ratios comfortably exceed the "well capitalized" required minimums.

## Reverse Stock Split Will Take Effect March 1, 2017

**REVERSE STOCK SPLIT SHOULD PROVIDE A NUMBER OF BENEFITS**

The Company's upcoming 1-for-5 reverse stock split (which will essentially have the effect of reducing the number of shares outstanding by roughly 80% but resulting in a higher stock price) will take effect on March 1, 2017. The reverse stock split is expected to broaden the Company's investor base, reduce trading costs, improve liquidity and make it easier to track per share progress in earnings and dividends.

## Asset Quality Remains Good

**NPAS /ASSETS: 0.83%, VS. 1.21% AT THE YEAR-AGO DATE**

As of December 31, 2016, NPAs were $6.0 million, or 0.83% of assets, versus $5.9 million, or 0.82% of assets, at September 30, 2016 and $8.4 million, or 1.21% of total assets, at the end of 2015. The Company's allowance for loan losses was $9.6 million (1.90% of loans) at December 31, 2016, versus $9.6 million (2.10% of loans) at the year-ago date.

## Projections Maintained

**EPS:**
**2015A: $0.11 ***
**2016A: $0.11 ***
**2017E: $0.12 (FULLY TAXED)**

*** EXCLUDES DEFERRED TAX BENEFITS**

Based on the most recent results, we are essentially maintaining our 2017 earnings projection of $3.8 million, or $0.12 per diluted share ($0.58 per diluted share on a post-split basis). These projections could vary significantly based on changing economic conditions.

ADDITIONAL INFORMATION UPON REQUEST