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COMPANY INTERVIEW

ROBERT C. HATLEY & STEVEN E. CROUSE Paragon Commercial Corporation (NASDAQ:PBNC)

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Paragon Commercial Corporation (NASDAQ:PBNC)



ROBERT C. HATLEY, President and CEO, founded Paragon Commercial Corporation — Paragon Bank — in 1999. A native of Concord, Mr. Hatley received his Bachelor of Science in business administration from Appalachian State University in Boone, North Carolina. For the next 14 years, he served with Wachovia Bank as a Field Representative, a Credit Manager, a Branch Manager and City Executive. From 1988 to 1998 Mr. Hatley worked with Peoples/Centura Bank, serving the last four years as Regional Market Manager of the Wake County commercial market. Mr. Hatley was named 2008 Carolinas Ernst & Young Entrepreneur of the Year for financial services. Mr. Hatley has been involved in community service for many years. In 2015 he was appointed by Gov. Pat McCrory to serve a four-year term on Appalachian State University's board of

trustees. He also served as the 2015-2016 Chairman of the North Carolina Bankers Association and on the Leadership Council of the WakeEd Partnership. Previously he served as Chairman of the board of the Cary Chamber of Commerce. He is also past President of the Cary Rotary Club and past Director of the Greater Raleigh Chamber of Commerce, Hospice of Wake County, Wake Med Foundation and North Carolina Chamber. He served as Chairman of First Tee of the Triangle in 2014 and is the past Chairman of the foundation board of the Cary Rotary Club. In addition, he served on the board of visitors of Appalachian State University.



STEVEN E. CROUSE is Executive Vice President and Chief Financial Officer at Paragon Commercial Corporation. Mr. Crouse is responsible for overseeing the day-to-day financial processes of the bank, as well as focusing on the strategy behind budgets, planning, forecasts, contract review, developing policies, asset liability management and vendor relations. With more than 23 years in the industry, Mr. Crouse is a great asset to Paragon Bank and all of its clients. Prior to becoming Paragon Bank's CFO more than nine years ago, Mr. Crouse spent eight years at McGladrey & Pullen, where he worked in both the audit and tax divisions. In 1998, Mr. Crouse became the Controller at Capital Bank, which at the time was a \$90 million startup. He was Capital Bank's interim CFO for nine months before joining Paragon Bank in early 2005 to start the finance department, which had previously been outsourced. Mr. Crouse is a CPA

and a member of the American Institute of Certified Public Accountants and the North Carolina Association of Certified Public Accountants. In the community, Mr. Crouse has been an active Cub and Boy Scout leader, including five years as a Cub Master for a pack with 110 cubs. He joined the Oconeechee Council board of directors eight years ago and spent the past two years as the Director of Finance, also serving on the executive committee, the investment committee, the finance committee and the audit committee (Ex-Officio). He has been awarded numerous leadership awards for his service with the Boy Scouts of America and is an Eagle Scout himself. Additionally, he served on the board for The First Tee of the Triangle, where he was Treasurer and part of the executive committee, and he is still on the board for Junior Achievement of Eastern North Carolina where he is also Treasurer. For his active involvement in the community, he was selected by Triangle Business Journal as the 2013 Triangle CFO of the Year. A native of Winston-Salem, North Carolina, Mr. Crouse attended NC State University, where he earned bachelor's degrees in accounting and business management.

SECTOR — BANKING

(BAJ603) TWST: Can you describe the bank and its services?

Mr. Hatley: We opened in May of 1999 and offer businesses and individuals a private banking experience. We do that through three offices in two vibrant markets in North Carolina and have grown to have assets of \$1.50 billion. We are not a typical community bank. Anyone can bank with us, but our private banking

approach attracts clients who expect a higher level of attention from experienced bankers, which creates a better client experience.

Our product focus is on deposit and loan services for businesses and individuals. We respect the fact that many of our clients already have wealth management relationships with others they trust, so we don't offer wealth management service. If a client asks, we refer them to one of our strategic partners. We provide courier services to

our business clients, and all clients have free use of ATMs worldwide. Simply put, we provide businesses and wealthy individuals with a high level of attention and service with our highly talented account officers, which we call Client Development Officers, CDOs.

“If you look over 2014 and 2015 to where we are today, our return on equity has gone from 9.6% in 2014 to 12.2% in 2015 to again double-digits even as recently as the first quarter after the IPO share issuance.”

TWST: Would you describe the individuals primarily as businesses, or who is the bank for and not for?

Mr. Hatley: When we started, we were a bank for businesses. Since then, we have expanded our focus into private banking for executives and individuals. A typical company that we work with is one with revenues of between \$5 million and \$75 million. We tend to attract businesses and also individuals who frankly have been pushed down by the big banks to branches instead of into private offices where they used to meet. A typical private banking client would be someone who in our estimation would have \$100,000 or greater in bank deposits they might keep with Paragon.

TWST: Paragon Commercial Corporation, your parent, went public in the last year. Could you depict your financial status, including events over the last year, for us in whatever manner you choose to?

Mr. Hatley: I will tell you a little bit about the stock and what is going on with the bank, and I will let Steve give more specifics on the numbers. We started in 1999 as a privately held company. You only had to buy one share of stock back in 1999, but the price was \$52,500. There were 314 shareholders initially in the company. Through the history of the bank, we have had a series of stock splits, although we were not paying dividends. We were very thinly traded over my desk.

At the end of 2014, we decided to do a stock split to get it down to a price that would be more in line with other banks that were similar in size to us. We did a 125-to-1 stock split and then traded over the counter initially in February of 2015 when the price then was trading at \$10 a share. We decided that was step one.

Step two was to do an IPO, which is what we completed in June of 2016, for several reasons. One was we wanted to get additional capital to grow the bank, and two, we wanted to get more institutional ownership in the bank. This was a 93% institutional capital raise that we did as an IPO to provide our shareholders more value and liquidity. The result was the stock moved from \$10 a share a year and a half ago to trading over \$40 a share now.

Mr. Crouse: We have had a continuing track record of really solid performance. In the April issue of *American Banker* magazine we were ranked one of the top 200 banks in the country based on return on equity over a three-year average. We have been posting double-digit returns on equity for the last couple of years. This year has been really good. While we have only been public

through the SEC since June, we were trading over the counter prior to that, and our financials have been available there since early 2015, plus you can pull our financial data from SNL pretty easily as well.

If you look over 2014 and 2015 to where we are today, our return on equity has gone from 9.6% in 2014 to 12.2% in 2015 to again double-digits even as recently as the first quarter after the IPO share issuance. We had double-digit ROE again in the third quarter of this year and over the year-to-date period. So performance has been strong.

Our credit numbers are also really good. We had a couple of consecutive quarters of zero dollars of past due loans — as in no past due loans at all. We were pretty proud of that. Our return on assets has been approaching 1%, which is pretty solid for a community bank in the southeastern part of the United States. Overall, we have been posting really good numbers.

TWST: Can you describe your loan mix currently and what plans you have to change that mix over the next two years?

Mr. Hatley: The optimum situation would be for us to be one-third in income-producing commercial real estate — CRE — one-third in commercial and industrial — C&I — operating company relationships, and one-third in private banking. Within private banking are equity lines, home mortgages, second homes, boats, etc. Right now CRE is about 44% of the portfolio, and in our markets here in North Carolina, because it is such a growth market in Raleigh and Charlotte, that is really not a bad number for us.

I suspect that we will always have slightly more in income-producing CRE than we will in the other two, but it is fairly close. To improve our C&I mix, we have hired more C&I lenders. That number is going to continue to increase. About 31% of our portfolio is now in C&I, and then the remaining is in private banking.

Mr. Crouse: We have had the benefit of having really strong and rapid growth in a bustling state. Our loan portfolio has grown at an annualized pace of about 20%, which is probably a little faster than we would want. Our net income year over year through September is up 18%. We have had double-digit increases in earnings per share and in net income consecutively over the last couple of years, and that has really been driven by the robust growth we have had. We have almost \$200 million in loan growth on a \$1 billion portfolio so far this year.

TWST: To what do you attribute the loan growth? Is it multiple variables as in more developing relationships as well as construction going on in the area?

Mr. Hatley: It is multiple factors. One of the bigger ones is we happen to be in two of the best growth markets in the country in Raleigh and Charlotte. Of course with that comes a lot of competition, too. We also have established a really good brand over the last 18 years and have hired extremely good talented people that we tend to keep.

One of the things that we are very proud of is our turnover ratio is half that of the national average in the banking sector. So we end up hiring really good people and keep them happy. Most of them have come from both a big bank environment and then moved to a small bank environment, so they are well-trained and understand banking, and yet they still have an entrepreneurial background by having worked with a small bank. They tend to stay.

We are structured to have very large portfolios with a lot of support staff behind them, so our client development officers can be out on the street talking to clients and prospects. We get a lot of

referrals coming to the bank because of our reputation. So it is a combination of the market, our brand and the talent that we have.

“For next year we will continue to increase our C&I business, which all the banks now are very keenly interested in, and the way we will do that is that is over the last year and up until even now, we are hiring more account officers that will be focused exclusively on C&I relationships.”

Mr. Crouse: A couple of add-ons. I was at a conference just recently, and one of the comments I heard when a Wells Fargo economist was speaking is that we are in two of the top 10 metropolitan growth markets in the country. Raleigh was second to San Jose, and I think Charlotte was sixth in the country. These are the growth markets that we are headquartered and operating in. Bob mentioned how we tend to keep people, and that is also something we are very proud of. For last two years, we have been one of the top 10 banks in the country to work for according to *American Banker* magazine.

TWST: What metrics that you track do you find to be the most important and why?

Mr. Hatley: One is obviously profitability. We want to be over 1% ROE and to keep pushing beyond that. So profitability and earnings per share are very important to us. Our efficiency ratio is also important. We are probably second in the state and among the best in the country in terms of our efficiency ratio. We have several peer groups that we identify with. Our efficiency ratio is partly due to our business model whereby we have only three offices. People talk about branch-light banks, and we are one of the role models for that in that we have \$1.50 billion in assets and only three offices.

Credit quality is an area where we are among the leaders in the state. Our NPAs are sub-.50% as a percent of assets and are continuing to go down. Our past dues basically are nonexistent. We are not seeing any uptick in our markets in credit deterioration at all. So credit quality is important and, of course, the fact that we pay a whole lot of attention to our loan growth and fund it with core deposits is one of the real shining stars of our accomplishments over the last four to five years. When we started the bank, the FDIC and the banking commission actually approved us to fund ourselves up to 70% with brokered deposits. This was back in 1999 when you could do that, and we did. We were as high as slightly over 70%. We are down now to under 8% of brokered deposits as a percent of total deposits.

Mr. Hatley: So we made a decision about this five years ago because we really wanted to increase the franchise value of the company, and we felt we could do that through core deposit growth. You have to both fund yourself and lend locally. We were lending locally but not funding ourselves locally. We made a concentrated effort, and rolled our sleeves up and hired the right kind of people. We incented people properly.

As a result, our balance sheet has completely changed if you look at the funding and frankly has completely changed when you look at the lending relative to what it was in 2005, 2006 and

2007, when we were putting a lot of development loans on the books because Raleigh and Charlotte were very much boomtowns back in those days. A lot of national and local builders were coming into the market and building a lot of houses. That all stopped. As a result, we were stuck with a lot of nonperforming A&D development loans that we had to work our way through.

We have now taken that portfolio down to only two development loans, and they are very, very good loans with strong guarantors, so we are not concerned about them. But that experience has changed our model. If you look at our bucket of construction loans to capital, we are half of the regulator-suggested guidelines of 100%. We are less than 50% because we are just not doing what we believe to be the riskiest type of lending out there, construction loans. We certainly have not done any new development land loans.

Mr. Crouse: To put some numbers around some of the things Bob said between internet and broker deposits, we have gotten rid of about \$800 million in those types of funding. We were over \$750 million in broker deposits, and we are sub-\$100 million now. We have paid off \$130 to \$140 million in internet deposits as well. So we have seen a dramatic shifting in funding.

Bob talked about efficiency, and one thing I would point out is that if you looked at a typical community bank of our size, it will have 30 to 35 branches and 350-plus employees, and as we have stated, we have three offices and about 140 to 150 employees. So we have got a lot less mouths to feed and a lot less real estate to pay for.

TWST: Can you tell me your strategic objectives for the next year?

Mr. Hatley: For next year we will continue to increase our C&I business, which all the banks now are very keenly interested in, and the way we will do that is that is over the last year and up until even now, we are hiring more account officers that will be focused exclusively on C&I relationships. We will continue to push hard to get relationships that have a lot of deposits we can handle for them. We want to continue doing what we have done over the last four years: increase our loan growth, which has been in the 15% to 20% range every year, and continue to reduce our level of broker deposits. We have no internet deposits left and very low brokered funds, which we have replaced with core deposits. So really there are no major changes in what we have done over the last two years, and that has continued to be double-digit loan growth funded locally with core deposit growth.

Mr. Crouse: We will continue to drive toward higher ROA and ROE every year.

Mr. Hatley: We are constantly shooting to keep our efficiency ratio to the low 50s. Next year, we would like to see us get to sub-50%. We consider our efficiency as our golden goose. We do not want to destroy that. So as we grow, we will continue to carefully manage expenses.

TWST: In terms of your long-term growth, do you see it happening all organically or in some part through acquisition, and, if organically, what avenues of the business do you want to contract a little bit more as you expand others?

Mr. Hatley: We have never done any acquisitions. We do not plan to do acquisitions. I would never say never if there is an opportunity, but to find a bank that is similar to Paragon would be very difficult. For us, it would not make a whole lot sense to acquire a bank and then have to gut it because it doesn't have the type of

client relationships we want or it has unnecessary overhead. So we will continue doing what we have done.

I tell people when we do our investor presentation that we could triple the size of the bank and never leave Wake County where Raleigh is and Mecklenburg County where Charlotte is located. So we will continue to hire talented account officers who bring in more business. Over the last 60 days, we have gotten either commitments or brought on board four new account officers. We have built a strong brand over the last 18 years that helps us attract high-caliber people. That is what we are going to do. We just can't keep layering on more on our existing staff, so we are adding C&I and private bankers and deposit people. We are just going to keep on doing what we have been doing for the last three to four years.

TWST: What do you want a potential investor in Paragon Commercial Corporation or Paragon Bank to know today about you, and as you answer that, please point out anything that might distinguish you from your local or regional peers, whoever you consider to be your local or regional peers?

Mr. Hatley: We tell people constantly including in our investor presentations that we are a very vanilla company. We are a spread organization. We do not chase fees. We do not aggravate our clients with fees. We do this because we make money the old-fashioned way by lending money and gathering local deposits. The deposits happen to cost us less relative to what we charge for the loans.

We have talented account officers who provide an

extraordinary client experience. We recognize our employees. At the end of the day, we provide well for the people that we call on and work with. We do that better than anyone else in our market. We are not for the masses and never will be. We just don't have that level of volume, nor do we have any desire to have that level of volume. The people who bank with us have relatively large deposits and large loans and, because of that, our account officers don't have thousands of customers or clients they have to take care of, so the ones they do have they can really spend a lot of attention on. That works exceedingly well for us.

TWST: Is there anything else you wanted to add that we haven't talked about?

Mr. Hatley: No, I think you get a good picture of what we're all about.

TWST: Thank you. (KJL)

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