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Union Bank (UBNC – OTCQX)

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Price:	\$14.68	EPS*	2017A:	\$ 0.55			
52 Wk. Range:	\$13.80 - \$15.10	(FY: DEC)	2018A:	\$1.12	P/E	2018A:	13.1 x
Div/Div Yld:	\$0.20 / 1.4%		2019A:	\$1.19		2019A:	12.3 x
Shrs/Mkt Cap:	6.0 mm / \$87 mm	Tangible Book Value:	\$11.98		Price/Tang. Book Value:		1.23 x

* EPS are diluted. Book value per share is \$14.36.

Background

Union Bank (“the Bank”) is the resulting Bank from the 2017 merger of the little bank with Union Banc Corp. Headquartered in Greenville, NC, it currently has \$821 million in total assets and primarily serves central and eastern NC through 14 full-service offices located in Lenoir, Granville, Wayne, Franklin, Vance, Onslow, Person, Pitt, Craven, New Hanover, and Wake Counties, as well as a loan production office in Burlington, NC. The Bank provides banking and financial services to individuals and small to medium-sized businesses, with an emphasis on providing its customers with “modern day technology combined with old-fashioned personal customer service.” Products offered include personal and business checking, savings, and money market accounts, personal, mortgage and business loans, and personal and business credit cards. The Bank also provides options for mobile and online banking, e-statements and digital wallets. The Bank’s stock is traded on the OTCQX marketplace under the symbol UBNC. With this report, we initiate coverage of Union Bank.

Fourth Quarter Results Were Strong; ROATE Was an Impressive 10.5%

Union Bank reported solid results for the fourth quarter of 2019. Net income was up about 6% from the year-ago quarter, with earnings benefitting from higher net interest and noninterest income, the latter of which did get a boost from security gains. And while noninterest expense did go up, it was relatively contained and was more than offset by the improvement in other areas. The profitability ratios implied by this level of earnings was also impressive, as the return on average tangible equity (“ROATE”) was 10.5%. [Core ROATE, which excludes security gains, as well as the amortization of intangibles (a non-cash charge), was 10.2%]. Moreover, balance sheet growth was strong, with gross loans increasing 13% over the past year. Finally, we would note that asset quality was exemplary. Nonperforming assets declined both from the year-ago date and the end of the third quarter of 2019, and have not been this low in more than five years (longer than that if we combine Union Bank and the little bank for historical comparisons). So all in all, it was a great quarter.

In terms of specifics, net income for the fourth quarter of 2019 was \$1,846,000, or \$0.31 per diluted share, up from \$1,737,000, or \$0.29 per diluted share, for the year-ago quarter. Net interest income increased 4% to \$6,957,000 in 2019’s fourth quarter, versus \$6,675,000 in the year-ago quarter. All of that increase was volume based, as margins remain under some pressure. Noninterest income, excluding gains on the sale of securities of \$207,000 in the fourth quarter of 2019 (there were none in the year-ago quarter), totaled \$715,000, compared to \$728,000 in 2018’s fourth quarter. Noninterest expense was up 8% to \$5,399,000 in 2019’s fourth quarter from \$5,016,000 in the year-ago quarter. Finally, the provision for loan losses for the fourth quarter of 2019 was \$188,000, versus \$242,000 in the year-ago quarter, reflecting favorable asset quality and reserve coverage metrics.

Full Year Results Were Likewise Favorable

Union Bank reported solid results for the full year 2019 as well, with earnings of \$7,159,000, or \$1.19 per diluted share, versus \$6,737,000, or \$1.12 per diluted share, for the year 2018. Net interest income

SYMBOL: UBNC

TOTAL ASSETS: \$821 MM

HQ: GREENVILLE, NC

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4TH QUARTER HIGHLIGHTS:

NET INCOME GREW 6%, EPS WAS UP 7%

EPS: \$0.31 vs. \$0.29

NET INTEREST INCOME INCREASED 4%

AVERAGE EARNING ASSETS WERE UP 8% AND DROVE NET INTEREST INCOME

FULL YEAR 2019 HIGHLIGHTS:

EPS: \$1.20 vs. \$1.12

LOAN GROWTH HAS BEEN EXCELLENT, UP 13% FROM 2018

UNION BANK HAS A STRONG MANAGEMENT TEAM THAT SUCCESSFULLY INTEGRATED THE OPERATIONS OF THE LITTLE BANK AND UNION BANC CORP.

THE RESULTING ENTITY IS MUCH LARGER AND MORE PROFITABLE

UNION BANK IS ALSO OF A SIZE THAT ITS VALUE MAY BENEFIT AS IT EXCEEDS THE \$1 BILLION MILESTONE

RELATIVE TO ITS PEERS, UNION BANK HAS A HIGHER ROATE, A HIGHER LOAN GROWTH RATE AND BETTER ASSET QUALITY

DESPITE ITS STRONG PERFORMANCE, ITS PRICE MULTIPLES ARE REASONABLE

ITS DIVIDEND YIELD IS SLIGHTLY HIGHER THAN PEERS AS WELL

NPAS-TO-ASSETS: 0.16%

RESERVES-TO-LOANS: 0.86%

grew 4%, noninterest income (excluding security gains and losses) was down about 3% and noninterest expense increased 4% from the year 2018. The provision for loan losses was \$941,000 for the year 2019, up from \$779,000 for 2018. Core ROATE was 10.8% for the year. As was mentioned earlier, balance sheet growth from year-end 2018 to year-end 2019 was led by loans, which were up 13%, while deposits grew 8% and total assets were up 10%. The Bank maintains a strong capital position, with shareholders' equity of \$85.4 million, or 10.40% of assets, at December 31, 2019, versus \$78.2 million, or 10.49%, at the year-ago date.

From Our Perspective, It is An Interesting Time for Investors to Consider Union Bank

From our standpoint, there are several things that intrigue us about Union Bank. First, it is a well-managed bank with a seasoned team. Rob Jones, the President and CEO (who has nearly 40 years banking experience, half of which at the Bank), has a great understanding of the evolving role of technology, his comment to us that "the phone is the new branch" reflecting his understanding that banks must increasingly scrutinize the cost/benefit of branches within their distribution systems. Second, Union is also interesting from the standpoint of size. The \$1 billion in assets milestone is not that far away, and while there is nothing magical about that number, the fact is that banks tend to get some pick up in valuations as they become larger, and the \$1 billion in asset size tends to be one of the key distinctions (in terms of size) recognized by the market. Third, we would point to the successful merger between the little bank and Union Banc Corp. The combined entity currently has \$821 million in assets, \$572 million in net loans and \$7,159,000 in trailing 12-month earnings. Those figures for the two individual banks (summed together) immediately prior to the announcement of the merger in 2016 were \$666 million in assets, \$477 million in net loans and \$4,730,000 in earnings. The point is that the management team has been highly successful in integrating the operations and building the franchise and earnings, which gives us greater confidence that it can use acquisitions as a viable means to build long-term shareholder value.

Union Bank's Relative Value Looks Interesting As Well

Union Bank performs quite well relative to similarly sized North Carolina banks, which we have defined as NC banks with assets between \$200 million and \$5 billion. Union Bank's ROAA is slightly lower than the peers, but frankly, that is partly due to the excess ("free") capital of its peers (i.e., excess capital levels tend to inflate ROAA ratios). If we look at core ROATE, we see that Union has a much higher level of profitability per dollar of tangible equity. Loan growth is much higher, and asset quality is much stronger as well. Despite the superior performance ratios, the shares trade at essentially market multiples with a higher dividend yield.

	Core ROAA LTM	Tangible Equity/Assets	Core ROATE LTM	Loan Growth LTM	NPAs/Assets	Dividend Yield	Price/TTM Core EPS	Price/Tang. Book Value
UBNC	0.94%	8.8%	10.76%	13.4%	0.16%	1.36%	11.9x	1.23x
Peer Median	1.10%	11.1%	9.15%	4.2%	0.34%	1.06%	11.7x	1.23x

Asset Quality is Excellent

Nonperforming assets ("NPAs"), which includes nonaccruing loans, loans more than 90 days past due and still accruing and OREO, were \$1,301,000, or 0.16% of total assets, compared to \$2,164,000, or 0.27% of assets, at September 30, 2019, and \$2,269,000, or 0.30% of total assets, at the year-ago date. Included in the above NPAs are purchased credit-impaired loans that are currently past due greater than 90 days and accruing. The allowance for loan losses totaled \$5.0 million, or 0.86% of total loans at December 31, 2019, which was up 23% from \$4.0 million, or 0.80% of total loans, at the year-ago date.

ADDITIONAL INFORMATION UPON REQUEST

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