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UB Bancorp (UBNC – OTCQX)

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July 27, 2020

Price:	\$10.05	EPS*	2018A:	\$ 1.12	P/E	2018A:	9.0 x
52 Wk. Range:	\$8.81 - \$15.00		2019A:	\$ 1.19		2019A:	8.4 x
Div/Div Yld:	\$0.20 / 2.0%		TTM 6/30/20A:	\$ 1.02		TTM 6/30/20A:	9.9x
Shrs/Mkt Cap:	5.9 mm / \$60 mm	Tangible Book Value:		\$ 12.86	Price/Tang. Book Value:		0.78 x

* EPS are diluted. Book value per share is \$15.18.

Background

UB Bancorp (the “Company”) is the recently established (May 1, 2020) holding company for Union Bank. 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 \$1.0 billion 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 Company’s stock is traded on the OTCQX marketplace under the symbol UBNC.

The Second Quarter of 2020 Was a Significant Quarter for the Company

The second quarter of 2020 was one of the most significant ones in the Company’s recent history. To begin, on May 1, 2020, a holding company was formed, which as we discuss later, will provide numerous benefits to the Company. Additionally, the Company issued \$25 million in subordinated notes, which provides a long-term source of capital and positions the Company for continued growth. Third, the Bank was active in helping customers who have been adversely impacted by COVID-19, lending approximately \$65 million to small business customers through the SBA’s Payroll Protection Program (“PPP”). That loan growth helped to propel the Company’s total assets to an important milestone: \$1 billion. Even if the Company drops below that milestone once PPP loans are repaid or forgiven, it is clearly making headway towards it, which is important in that larger banks tend to be valued at higher multiples than smaller banks, all else being the same. Finally, the Company had solid operating metrics in the quarter. Although reported earnings were lower, the decline was due primarily to a higher provision for loan losses, the absence of which would have led to an earnings increase.

In terms of specific results, net income for the second quarter of 2020 was \$612,000, or \$0.10 per diluted share, as compared to \$1,771,000, or \$0.30 per diluted share, in the year-ago quarter. As was stated above, the primary reason for the lower earnings was a significant increase in the provision for loan losses, which grew to \$2,200,000 in 2020’s second quarter from \$260,000 in 2019’s second quarter. If we eliminate the provision and nonrecurring gains and losses, we see that this “adjusted pretax earnings” increased more than 10% from the year-ago quarter and was, in fact, the highest over the past five quarters.

Quarterly Results (\$000s)	2019			2020	
	Q2	Q3	Q4	Q1	Q2
Net Income	1,771	1,904	1,846	1,733	612
Pretax Income	2,216	2,382	2,292	2,143	686
Eliminate:					
Provision	260	281	188	355	2,200
Nonrecurring Gains/Losses	(149)	(136)	(165)	(121)	(323)
Adjusted Pretax Earnings	2,327	2,527	2,315	2,377	2,563

SYMBOL: UBNC

TOTAL ASSETS: \$1.0 B

HQ: GREENVILLE, NC

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2ND QUARTER HIGHLIGHTS:

2020’S SECOND QUARTER WAS QUITE SIGNIFICANT IN THAT IT INCLUDED:

- **THE CREATION OF A HOLDING COMPANY**
- **A \$25 MILLION NOTES ISSUANCE**
- **ACTIVE PPP PARTICIPATION**
- **SOLID FINANCIAL RESULTS**

THE PROVISION FOR LOAN LOSSES INCREASED SIGNIFICANTLY

ADJUSTED PRETAX INCOME BEFORE THE PROVISION GREW 10%

EPS: \$0.10 vs. \$0.30

AVERAGE EARNING ASSETS WERE UP 25% FROM THE YEAR-AGO QUARTER, WHICH OFFSET A DECLINE IN MARGINS

FIRST HALF HIGHLIGHTS:

EPS: \$0.39 vs. \$0.57

PRETAX INCOME BEFORE THE PROVISION AND GAINS INCREASED 10%

FROM 6/30/19 TO 6/30/20: ASSETS WERE UP 29%, LOANS GREW 19% AND DEPOSITS INCREASED 16%

THE ESTABLISHMENT OF A HOLDING COMPANY WILL RESULT IN A NUMBER OF BENEFITS

\$25 MILLION IN NOTES WERE ISSUED, WHICH HAS BOOSTED CAPITAL

UNION BANK CONTINUES TO WORK WITH ITS COVID-19 AFFECTED CUSTOMERS

NPAS WERE DOWN FROM THE YEAR-AGO AND LINKED QUARTERS

NPAS-TO-ASSETS: 0.05%

RESERVES-TO-LOANS: 1.17%

UB BANCORP HAS BETTER ASSET QUALITY METRICS THAN MOST SOUTHEAST BANKS

The strength in “normalized” earnings came mainly from solid revenue growth. Net interest income growth was strong, increasing 11% to \$7,447,000 in the second quarter of 2020 from \$6,731,000 in the year-ago quarter. Although margins were lower (3.46% in 2020’s second quarter versus 3.79% in the year-ago quarter), average earning assets growth was sufficiently high (+25%) that it more than offset the margin impact. Noninterest income totaled \$1,033,000 in 2020’s second quarter, up 7% from \$966,000 in the year-ago quarter, while noninterest expense grew 7% to \$5,594,000 from \$5,221,000 over this period.

Results for the first half of 2020 were likewise impacted by a much higher provision. Reported net income was \$2.3 million, or \$0.39 per diluted share, in the first half of 2020, versus \$3.4 million or \$0.57 per diluted share, in the year-ago period. Excluding the provision, which was \$2.6 million in 2020’s first six months, as compared to \$0.5 million in the first six months of 2019, pretax income before the provision and nonrecurring gains/losses was \$4.9 million, which was up 10% from \$4.5 million for the first half of 2019. Net interest income grew 8%, noninterest income was up 4% and noninterest expense increased 5% from the first half of 2019. Balance sheet growth was also quite good. From June 30, 2019 to June 30, 2020, loans, deposits and assets were up 19%, 16% and 29%, respectively. Shareholder’s equity totaled \$91 million, or 9.1% of total assets, at June 30, 2020. Overall capital levels were strong, with the Bank having a leverage ratio of 8.96%, tier 1 capital ratio of 12.66% and a total capital ratio of 14.80% at June 30, 2020.

The Holding Company Formation and Notes Offering Position the Company for Growth

As was mentioned earlier in the report, the Company established a holding company effective May 1, 2020. The establishment of a holding company does several things for the Company. It provides greater flexibility to the Board as it reviews capital structure, as well as making it easier to maintain dividends and pursue growth opportunities. All of the Bank’s capital ratios are quite strong, as are its liquidity ratios. Those ratios got a boost from the recent (May 29, 2020) issuance of \$25 million in subordinated ten-year notes by the Bank’s holding company. During the quarter, UB Bancorp injected \$7.25 million into the Bank to support its growth.

The Bank Continues to Work With Its COVID-19 Affected Customers

During the quarter, the Bank processed over 300 applications for loan payment relief totaling about \$90 million (15% of its non-PPP loan portfolio). The Bank offered two options for borrowers seeking payment relief: 1) 90 days of full payment relief or 2) 6 months of interest only payments. The vast majority of all borrowers that chose full payment relief have returned to regularly scheduled payments.

Asset Quality is Excellent and Superior to the Majority of Southeast Banks

UB Bancorp continues to have excellent asset quality. Nonperforming assets (“NPAs”) (which include nonaccruing loans, loans more than 90 days past due and still accruing and OREO), were \$521,000, or 0.05% of total assets, at June 30, 2020, which was down from \$606,000, or 0.07% of total assets, at March 31, 2020, and \$1,670,000, or 0.21% of total assets, June 30, 2019. Net charge offs/average loans have also been low, most recently at 0.01% in 2020’s second quarter. UB Bancorp is defensively postured relative to many institutions, as it has a lower level of NPAs/assets, while having a higher reserves/loans ratio, as compared to a broad group of Southeast banks (there were 68 in the peer group with total assets between \$500 million and \$2.0 billion). The Company’s allowance for loan losses was \$7.5 million, or 1.17% of total loans at June 30, 2020, which was up from \$4.7 million, or 0.87% of total loans, at the year-ago date. As can be seen from the adjacent table, the Company’s reserves to NPAs was also much higher than the peer group median, and was in fact, the strongest in the group.

ASSET QUALITY VS. SOUTHEAST PEERS		
	UB Bancorp	SE Peer Group Median
NPAs/Assets (%)	0.05	0.39
Reserves/Loans (%)	1.17	1.02
Reserves/NPAs (x)	14.4	1.01

ADDITIONAL INFORMATION UPON REQUEST

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