

2014
SHAREHOLDER
UPDATE

Q1



TO OUR SHAREHOLDERS:

Following is our first quarter (Q1) 2014 report highlighted by a 1.3% year-over-year increase in net operating revenues, 16.1% growth in income from continuing operations, 13% growth in EBITDA from continuing operations and a 13.7% increase in cash flow from operations. During the quarter, we continued to expand our fiber network, increasing the number of homes and businesses that can experience the thrill of our Fiber Internet and Fiber TV products. Also, we announced that later this year we will launch a mass market gigabit Internet offering designed for homes and small businesses on our Fiber Internet platform. Gigabit Internet is much coveted by communities and is seen as a driver of economic growth, educational improvement and improved overall quality of life. With the investments we have made in fiber and our focus on making the Internet-driven life better, we are well positioned and excited to deliver this next click up in the digital ecosystem. Wholly owned DataChambers continues to lay the foundation for long term growth as our Raleigh, NC data center continues to ramp up, and construction has begun on our Charlotte, NC data center. Strategic revenues now account for 65% of our net operating revenues, depicting the ongoing transformation of North State to an Internet and data company.

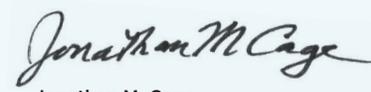
As we have shown in prior quarters and as is required by Generally Accepted Accounting Principles (GAAP), our income statement is classified into two main sections, income from continuing operations and income from discontinued operations (our wireless business segment, sold to AT&T in July 2013). We have disclosed various comparative metrics, including earnings per share, based on these two major components of our business. However, per GAAP, our cash flow statement is shown on a combined business basis, therefore cash flow from operations includes three months of wireless operations in 2013 and none in 2014. Please note that the included financial statements are unaudited.

The results for the first quarter highlight the capabilities and focus of the entire North State/DataChambers team. We are investing to improve the digital life and make businesses better, engaging with Internet- and data-driven users who will drive our growth.

Thank you for your support.


J. Patrick Harman
Chairman


Royster Tucker III
President & CEO


Jonathan M. Cage
Vice President & CFO

Q1 2014 CONSOLIDATED FINANCIAL HIGHLIGHTS

Q1 2014 consolidated net operating revenues from continuing operations were \$22.4 million compared to \$22.0 million in Q1 2013, reflecting growth in strategic revenues. Total operating expenses for the quarter were up 0.6% compared to Q1 2013, primarily due to increased costs within DataChambers as our new data centers ramp and costs related to a major ice storm that hit the Piedmont Region of North Carolina in March of this year. These costs were partially offset by lower costs in other areas coming from cost management initiatives. Costs of sales and services were up 0.5%. Sales, general and administrative expenses were down 0.9% for the quarter. Depreciation and amortization expense increased slightly due to the opening of our Raleigh data center in the last half of 2013. Q1 2014 operating income was \$3.1 million compared to \$2.8 million in Q1 2013. Non-operating income was \$1.7 million compared to \$1.2 million, reflecting an increase in equity in earnings of our wireless partnership and the falling off of expenses related to a 2013 donation of property. Q1 2014 income from continuing operations was \$2.9 million compared to \$2.5 million in Q1 2013, up 16.1%. Net income was \$2.9 million in Q1 2014 compared to \$3.6 million in Q1 2013. Earnings per share were \$1.27 compared to \$1.56. Earnings per share from continuing operations were \$1.27 in Q1 2014 compared to \$1.09 in Q1 2013. EBITDA from continuing operations was \$9.8 million compared to \$8.6 million.

Q1 2014 cash provided by operating activities was \$8.4 million, up 13.7% from \$7.4 million Q1 2013. Cash distributions from our wireless partnership were \$2.1 million in Q1 2014 compared to \$1.8 million in Q1 2013. Capital expenditures were \$4.2 million compared to \$2.3 million, reflecting fiber and data center expansion in 2014. Free cash flow (cash from operating activities plus cash distributions from our wireless partnership minus capital expenditures) was \$6.3 million in Q1 2014 compared to \$6.9 million in Q1 2013. Cash dividends were \$3.0 million in both Q1 2014 and Q1 2013.

NET OPERATING REVENUES STRATEGIC REVENUES

Q1 2014 strategic revenues were \$14.6 million, up 4.3% compared to Q1 2013, driven by gains in residential broadband and data center. Q1 2014 residential broadband revenues, which include Fiber TV, Fiber Internet and basic Internet products, were \$5.6 million, up 9.8% compared to Q1 2013, the result of growth in total residential broadband connections. There was an 8% increase in average revenue per connection, driven by continued adoption of higher speed Internet products. Residential Broadband connections totaled 39,395 at the end of Q1 2014, up 2.4% from Q1 2013. Data center revenues generated by wholly owned DataChambers were \$3.1 million in Q1 2014 compared to \$2.8 million in Q1 2013, with growth coming across colocation, cloud and disaster recovery services. Wireline business revenues were \$5.9 million in Q1 2014 compared to \$6.1 million Q1 2013, reflecting higher than anticipated levels of downward repricing on small business contract renewals and the nonrenewal of certain low-margin contracts during the quarter.

RESIDENTIAL LEGACY TELECOM, WHOLESALE, and ADVERTISING & SEARCH

Q1 2014 residential legacy telecom revenues, generated primarily from basic residential phone services, were \$3.5 million compared to \$3.8 million in Q1 2013. Wholesale revenues, generated primarily from access services, were \$3.5 million in Q1 2014, up from \$3.4 million in Q1 2013, reflecting some stabilization in federally mandated impacts on this segment. Advertising and search revenues generated from print and online advertising products were \$0.8 million in Q1 2014, down 7.8% compared to Q1 2013.

Summary of Statements of Net Income with Discontinued Operations—Unaudited

Amounts in millions except per share amounts

Three Months Ended March 31,	2014	2013	Change	% Change
Net operating revenues (after uncollectibles):				
Residential broadband	\$5.6	\$5.1	0.5	9.8%
Business wireline	5.9	6.1	(0.2)	-2.7%
Data center	3.1	2.8	0.3	9.7%
Total strategic	14.6	14.0	0.6	4.3%
Residential legacy telecom	3.5	3.8	(0.3)	-9.0%
Wholesale	3.5	3.4	0.1	1.6%
Advertising and search	0.8	0.8	0.0	-7.8%
Net operating revenue	22.4	22.0	0.4	1.3%
Operating expense:				
Cost of sales and services	9.0	9.0	0.0	0.5%
Selling, general, and administrative	5.5	5.6	(0.1)	-0.9%
Depreciation and amortization	4.8	4.6	0.2	2.7%
Total operating expense	19.3	19.2	0.1	0.6%
Operating income	3.1	2.8	0.3	5.5%
Nonoperating income (expense):				
Interest income	0.0	0.0	0.0	125.8%
Interest expense	(0.2)	(0.2)	0.0	3.8%
Equity in earnings of unconsolidated entities	1.9	1.8	0.1	7.4%
Net gain (loss) on sale of investment securities	0.0	0.0	0.0	
Other income (expense), net	0.0	(0.4)	0.4	103.1%
Total nonoperating income	1.7	1.2	0.5	48.1%
Income from continuing operations before income taxes	4.8	4.0	0.8	17.7%
Income taxes from continuing operations	1.9	1.5	0.4	20.4%
Income from continuing operations	2.9	2.5	0.4	16.1%
Discontinued operations:				
Income from operations of discontinued business segment	0.0	1.8	(1.8)	-100.0%
Income taxes from discontinued operations	0.0	0.7	(0.7)	-100.0%
Income from discontinued operations	0.0	1.1	(1.1)	-100.0%
Net income	\$2.9	\$3.6	(\$0.7)	-18.8%
Earnings per average common share (EPS)	\$1.27	\$1.56	(\$0.29)	-18.6%
EPS attributed to continuing operations	\$1.27	\$1.09	\$0.18	16.4%
EPS attributed to discontinued operations	\$0.00	\$0.47	(\$0.47)	-100.0%

Consolidated Balance Sheets—Unaudited

At March 31,	2014	2013
Assets		
Current assets:		
Cash and cash equivalents	\$ 8,890,372	\$ 2,290,294
Investment securities	13,962,275	-
Accounts receivable, net of allowance for doubtful accounts	8,143,264	8,518,180
Escrow receivable from wireless sale	2,350,156	-
Materials and supplies	1,756,868	5,101,317
Prepayments	1,267,931	1,605,318
Income taxes recoverable	583,382	2,423,604
Deferred income taxes	694,114	787,810
Assets held for sale, net of liabilities	-	10,377,139
Total current assets	<u>37,648,362</u>	<u>31,103,662</u>
Property, plant, and equipment	467,131,966	456,165,803
Less accumulated depreciation	<u>322,867,112</u>	<u>310,617,498</u>
Property, plant, and equipment, net	<u>144,264,854</u>	<u>145,548,305</u>
Other assets:		
Investment securities	4,626,325	3,888,352
Investments in unconsolidated entities	8,686,653	9,683,959
Intangibles, net of amortization	17,079,950	18,376,417
Goodwill	27,232,656	27,232,656
Other noncurrent assets	<u>1,259,276</u>	<u>1,360,267</u>
Total other assets	<u>58,884,860</u>	<u>60,541,651</u>
Total assets	<u>\$ 240,798,076</u>	<u>\$ 237,193,618</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Revolving credit note	\$ -	\$ 500,000
Current maturities of bank note	5,500,000	4,125,000
Accounts payable and payroll withholdings	2,944,184	2,507,737
Advance billings and customer deposits	3,391,146	2,947,879
Income taxes payable	1,486,798	884,253
Accrued expenses	9,030,066	5,451,817
Accrued taxes	<u>606,870</u>	<u>599,391</u>
Total current liabilities	<u>22,959,064</u>	<u>17,016,077</u>
Other liabilities:		
Bank note, net of current maturities	45,375,000	50,875,000
Deferred income taxes	31,691,835	20,761,739
Accrued pension benefits	17,201,981	42,256,927
Accrued postretirement benefits	973,446	1,495,803
Other liabilities and deferred credits	<u>711,209</u>	<u>780,166</u>
Total other liabilities	<u>95,953,471</u>	<u>116,169,635</u>
Total liabilities	<u>118,912,535</u>	<u>133,185,712</u>
Stockholders' equity:		
Preferred stock	1,946,300	1,961,400
Common stock	11,419,800	11,457,485
Paid in capital	47,324	47,422
Retained earnings	121,941,136	116,605,092
Accumulated other comprehensive loss	<u>(13,469,019)</u>	<u>(26,063,493)</u>
Total stockholders' equity	<u>121,885,541</u>	<u>104,007,906</u>
Total liabilities and stockholders' equity	<u>\$ 240,798,076</u>	<u>\$ 237,193,618</u>

Consolidated Statements of Net Income with Discontinued Operations—Unaudited

Three Months Ended March 31,	2014	2013
Operating revenues:		
Residential broadband	\$ 5,950,171	\$ 5,367,945
Business wireline	5,999,344	6,155,017
Data center	3,162,028	2,860,860
Total strategic	15,111,543	14,383,822
Residential legacy telecom	3,594,843	3,914,550
Wholesale	3,463,898	3,407,683
Advertising and search	761,315	829,584
Total operating revenues	22,931,599	22,535,639
Less uncollectible revenue	557,437	441,961
Net operating revenues	22,374,162	22,093,678
Cost of sales and service:		
General support	1,327,424	1,164,767
Central office	2,158,591	2,365,083
Communication termination	2,502,013	2,555,127
Cable and wire facilities	1,251,928	1,063,410
Network operations	1,791,368	1,834,719
Total cost of sales and service	9,031,324	8,983,106
Gross margin	13,342,838	13,110,572
Depreciation and amortization expense	4,755,816	4,631,036
Selling, general, and administrative expense:		
Customer operations	3,651,682	3,562,069
Corporate operations	1,559,290	1,716,482
Taxes, other than income taxes	334,927	318,784
Total selling, general, and administrative expense	5,545,899	5,597,335
Net operating income	3,041,123	2,882,201
Nonoperating income (expense):		
Interest income	31,514	13,959
Interest expense, net of capitalized interest	(255,751)	(265,733)
Equity in earnings of unconsolidated entities	1,933,400	1,801,001
Net loss on sale of investment securities	(1,083)	-
Other income (expense), net	12,149	(387,535)
Net nonoperating income	1,720,229	1,161,692
Income from continuing operations before income taxes	4,761,352	4,043,893
Income taxes from continuing operations	1,852,207	1,538,214
Income from continuing operations	2,909,145	2,505,679
Discontinued operations:		
Income from operations of discontinued business segment	-	1,755,374
Less: income taxes from discontinued operations	-	678,632
Income from discontinued operations	-	1,076,742
Net income	2,909,145	3,582,421
Preferred stock dividends	-	-
Net income available to common stockholders	\$ 2,909,145	\$ 3,582,421
Total earnings per average common share	\$1.27	\$1.56
Earnings per average common attributed to continuing operations	\$1.27	\$1.09
Earnings per average common attributed to discontinued operations	\$0.00	\$0.47
Dividends per common share	\$1.30	\$1.30
Weighted average common shares outstanding	2,283,960	2,291,744

Consolidated Statements of Comprehensive Income—Unaudited

Three Months Ended March 31,	2014	2013
Net income	\$ 2,909,145	\$ 3,582,421
Other comprehensive income, net of tax:		
Unrealized holding gains arising during the period, net of tax expense in 2014 of \$16,175 and tax expense in 2013 of \$69,079	24,932	105,875
Comprehensive income	\$ 2,934,077	\$ 3,688,296

Consolidated Statements of Stockholders' Equity—Unaudited

Three Months Ended March 31,	Preferred Stock	Common Stock	Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income			Total Stockholders' Equity
					Retirement Plans	Marketable Securities	Total	
Balance, January 1, 2013	\$ 1,965,600	\$ 11,463,565	\$ 45,658	\$ 116,084,044	\$ (26,160,721)	\$ (8,647)	\$ (26,169,368)	\$ 103,389,499
Acquisition of stock	(4,200)	(6,080)	1,764					(8,516)
Net income				3,582,421				3,582,421
Common stock dividends				(2,980,150)				(2,980,150)
Acquisition of common stock in excess of stated value				(81,223)				(81,223)
Unrealized gain on marketable securities, net of tax expense						105,875	105,875	105,875
Balance, March 31, 2013	\$ 1,961,400	\$ 11,457,485	\$ 47,422	\$ 116,605,092	\$ (26,160,721)	\$ 97,228	\$ (26,063,493)	\$ 104,007,906
Balance, January 1, 2014	\$ 1,946,300	\$ 11,423,490	\$ 47,324	\$ 122,047,933	\$ (13,791,294)	\$ 297,343	\$ (13,493,951)	\$ 121,971,096
Acquisition of stock	-	(3,690)	-					(3,690)
Net income				2,909,145				2,909,145
Common stock dividends				(2,969,148)				(2,969,148)
Acquisition of common stock in excess of stated value				(46,794)				(46,794)
Unrealized gain on marketable securities, net of tax expense						24,932	24,932	24,932
Balance, March 31, 2014	\$ 1,946,300	\$ 11,419,800	\$ 47,324	\$ 121,941,136	\$ (13,791,294)	\$ 322,275	\$ (13,469,019)	\$ 121,885,541

Consolidated Statements of Cash Flows—Unaudited

Three Months Ended March 31,	2014	2013
Cash flows from operating activities:		
Net income	\$ 2,909,145	\$ 3,582,421
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,755,816	4,908,897
Loss on sale of investment securities	1,083	-
Donated land	-	372,414
Loss on sale, disposal, and abandonment of other assets	115,021	62,714
Equity in earnings of unconsolidated entities	(1,933,400)	(1,801,001)
Deferred income taxes	47,875	195,736
Deferred pension and postretirement benefits	(117,246)	686,180
Changes in operating assets and liabilities:		
Accounts receivable	915,032	56,248
Materials and supplies	19,674	451,423
Other assets	1,286,575	(1,131,793)
Accounts payable and payroll withholdings	(1,069,374)	(1,845,537)
Accrued expenses	1,787,115	939,550
Other liabilities	(261,914)	960,738
Net cash provided by operating activities	<u>8,455,402</u>	<u>7,437,990</u>
Cash flow from investing activities:		
Additions to property, plant, and equipment	(4,150,888)	(2,294,616)
Cost of removal of telephone plant, net of salvage	(103,360)	3,358
Proceeds from sale of investment securities	4,100,000	-
Purchases of investment securities	(4,676,574)	-
Distributions from unconsolidated entities	2,091,780	1,801,255
Net cash provided by (used in) investing activities	<u>(2,739,042)</u>	<u>(490,003)</u>
Cash flows from financing activities:		
Principal payments on term loan	(1,375,000)	-
Proceeds (repayments) from revolving credit note, net	-	(5,500,000)
Acquisition of preferred stock	-	(2,436)
Acquisition of common stock	(50,484)	(87,303)
Cash dividends paid	(2,969,148)	(2,980,150)
Net cash used in financing activities	<u>(4,394,632)</u>	<u>(8,569,889)</u>
Net change in cash and cash equivalents	1,321,728	(1,621,902)
Cash and cash equivalents at beginning of year	7,568,644	3,912,196
Cash and cash equivalents at end of period	<u>\$ 8,890,372</u>	<u>\$ 2,290,294</u>
Short term investment securities at end of period	<u>\$ 13,962,275</u>	<u>\$ -</u>
Total cash, cash equivalents, and short term investment securities	<u>\$ 22,852,647</u>	<u>\$ 2,290,294</u>
Supplemental cash flow information:		
Cash payments (refunds) of income taxes	<u>\$ (150,532)</u>	<u>\$ -</u>
Cash paid for interest	<u>\$ 249,171</u>	<u>\$ 270,894</u>

I, Jonathan M. Cage, hereby certify that the accompanying unaudited consolidated balance sheets of North State Telecommunications Corporation and Subsidiaries as of March 31, 2014 and 2013 and the related unaudited consolidated statements of net income, comprehensive income, stockholders' equity, and cash flows for the three months then ended have been prepared from the Corporation's and Subsidiaries' accounting records. Internal accounting controls and review procedures provide assurance that these statements are materially accurate.

This is the 24th day of April 2014.



Jonathan M. Cage
VP-CFO, Secretary and Treasurer



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