

2014  
SHAREHOLDER  
UPDATE

Q2



## TO OUR SHAREHOLDERS:

Following are financial results for our second quarter and six months ended June 30, 2014. At the close of the second quarter of 2014, strategic revenues made up 67% 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 and therefore cash flow from operations includes six months of wireless operations in 2013 and none in 2014. Please note that the included financial statements are unaudited.

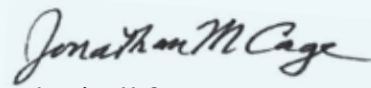
Our results highlight the focus of the entire North State and DataChambers teams. Expanding our engagement and interactions with internet driven people and businesses, improving lives and business, are at the focal points of our efforts.



J. Patrick Harman  
Chairman



Royster Tucker III  
President & CEO



Jonathan M. Cage  
Vice President & CFO

## **CONSOLIDATED FINANCIAL HIGHLIGHTS FOR THE THREE MONTHS ENDING JUNE 30, 2014**

Second quarter consolidated net operating revenues from continuing operations were \$22.4 million, up 1% compared to \$22.1 million in the second quarter of 2013. Operating income for the quarter was \$2.7 million compared to \$2.5 million in the second quarter of 2013. Non-operating income was \$1.9 million compared to \$2.3 million, with a 12.5% increase in equity in earnings of our wireless partnership; offset by a decline in second quarter 2014 other income. During the second quarter of 2013, we received a non-recurring dividend that increased other income for the period. Income from continuing operations was \$2.8 million in the second quarter of 2014 compared to \$3.0 million in the second quarter of 2013. Net income was \$2.8 million compared to \$3.9 million. Earnings per share were \$1.23 compared to \$1.69. Earnings per share from continuing operations were \$1.23 compared to \$1.29. EBITDA was \$9.6 million compared to \$11.4 million.

Cash provided by operating activities was \$4.0 million in the second quarter of 2014, impacted by pension costs and other working capital requirements which hit during the quarter, compared to \$8.2 million in the second quarter of 2013. Cash distributions from our wireless partnership were \$2.3 million in the second quarter of 2014 compared to \$1.9 million in the second quarter of 2013. Capital expenditures were \$2.8 million compared to \$4.9 million. Free cash flow (cash provided by operating activities plus cash distributions from our wireless partnership minus capital expenditures) was \$3.5 million compared to \$5.2 million. Cash dividends were \$3.0 million in the second quarter of both 2014 and 2013.

## **CONSOLIDATED FINANCIAL HIGHLIGHTS FOR THE SIX MONTHS ENDING JUNE 30, 2014**

For the first six months of 2014, net operating revenues from continuing operations were \$44.7 million, up 1.1% compared to \$44.3 million in first six months of 2013. Operating income for the period was \$5.8 million compared to \$5.4 million for the first half of 2013. Non-operating income was \$3.6 million compared to \$3.4 million. Income from continuing operations was \$5.8 million in the first six months of 2014 compared to \$5.5 million in the first six months of 2013. Net income was \$5.8 million compared to \$7.5 million. Earnings per share were \$2.50 compared to \$3.25. Earnings per share from continuing operations were \$2.50 compared to \$2.38. EBITDA was \$19.4 million compared to \$22.4 million.

Cash provided by operating activities was \$12.4 million in the first six months of 2014, compared to \$15.7 million in the first six months of 2013. Cash distributions from our wireless partnership were \$4.4 million the first six months of 2014 compared to \$3.7 million in the first six months of 2013. Capital expenditures were \$7 million compared to \$7.3 million. Free cash flow (cash provided by operating activities plus cash distributions from our wireless partnership minus capital expenditures) was \$9.8 million compared to \$12.1 million. Cash dividends were \$6.0 million in the first six months of both 2014 and 2013.

## NET OPERATING REVENUES

### STRATEGIC REVENUES

Strategic revenues for the second quarter of 2014 were \$15.3 million, up 7.8% compared to \$14.2 million in the second quarter of 2013 driven by gains in all strategic categories; residential broadband, wireline business and data center. Residential broadband revenues, which include Fiber TV, Fiber Internet, Fiber Voice and basic internet products, were \$5.9 million in the second quarter of 2014, up 16.2% compared to the second quarter of 2013. Residential broadband connections totaled 39,229 at the end of the second quarter of 2014, up 3% from the end of the second quarter of 2013. Data center revenues generated by wholly owned DataChambers, were \$3.2 million in the second quarter of 2014 compared to \$3.0 million in the second quarter of 2013. Wireline business revenues were \$6.2 million compared to \$6.1 million.

Strategic revenues for the first six months of 2014 were \$29.9 million, up 6.1% compared to \$28.2 million the first six months of 2013. Residential broadband revenues were \$11.5 million, up 13% compared to \$10.2 million. Data center revenues were \$6.3 million, up 8.2% compared to \$5.8 million. Wireline business revenues were \$12.1 million, slightly below the same levels as the first six months of 2013.

### RESIDENTIAL LEGACY TELECOM, WHOLESALE, and ADVERTISING & SEARCH

Residential legacy telecom revenues, generated primarily from basic residential phone services were \$3.2 million in the second quarter of 2014 compared to \$3.6 million in the second quarter of 2013. Wholesale revenues, generated primarily from access services were \$3.3 million compared to \$3.6 million. Advertising and search revenues generated from print and online advertising products were \$0.6 million compared to \$0.7 million.

Residential legacy telecom revenues were \$6.7 million in the first six months of 2014 compared to \$7.4 million in the first six months of 2013. Wholesale revenues were \$6.7 million compared to \$7.1 million. Advertising and search revenues were \$1.4 million compared to \$1.6 million.

## Summary of Statements of Net Income with Discontinued Operations—Unaudited

Amounts in millions except per share amounts

Six Months Ended June 30,	Quarter Ended June 30				Six Months Ended June 30,			
	2014	2013	Change	% Change	2014	2013	Change	% Change
Net operating revenues (after uncollectibles):								
Residential broadband	\$5.9	\$5.1	\$0.8	16.2%	\$11.5	\$10.2	\$1.3	13.0%
Business wireline	6.2	6.1	0.1	1.5%	12.1	12.2	(0.1)	-0.6%
Data center	3.2	3.0	0.2	6.1%	6.3	5.8	0.5	8.2%
Total strategic	15.3	14.2	1.1	7.8%	29.9	28.2	1.7	6.1%
Residential legacy telecom	3.2	3.6	(0.4)	-11.2%	6.7	7.4	(0.7)	-10.1%
Wholesale	3.3	3.6	(0.3)	-10.4%	6.7	7.1	(0.4)	-4.6%
Advertising and search	0.6	0.7	(0.1)	-12.9%	1.4	1.6	(0.2)	-10.2%
Net operating revenue	22.4	22.1	0.3	1.0%	44.7	44.3	0.4	1.1%
Operating expense:								
Cost of sales and services	9.0	9.0	0.0	-0.2%	18.0	18.0	0.0	0.2%
Selling, general, and administrative	5.9	6.0	(0.1)	-1.9%	11.4	11.6	(0.2)	-1.4%
Depreciation and amortization	4.8	4.6	0.2	2.7%	9.5	9.3	0.2	2.7%
Total operating expense	19.7	19.6	0.1	0.0%	38.9	38.9	0.0	0.3%
Operating income	2.7	2.5	0.2	8.8%	5.8	5.4	0.4	7.0%
Nonoperating income (expense):								
Interest income	0.0	0.0	0.0	227.4%	0.1	0.0	0.1	175.6%
Interest expense	(0.2)	(0.2)	0.0	-4.1%	(0.5)	(0.5)	0.0	0.0%
Equity in earnings of unconsolidated entities	2.0	1.8	0.2	12.5%	3.9	3.6	0.3	9.9%
Net gain (loss) on sale of investment securities	0.0	0.0	0.0		0.0	0.0	0.0	
Other income (expense), net	0.1	0.7	(0.6)	-93.2%	0.1	0.3	(0.2)	-80.7%
Total nonoperating income	1.9	2.3	(0.4)	-17.8%	3.6	3.4	0.2	4.5%
Income from continuing operations before income taxes	4.6	4.8	(0.2)	-3.8%	9.4	8.8	0.6	6.1%
Income taxes from continuing operations	1.8	1.8	0.0	-2.4%	3.6	3.3	0.3	8.1%
Income from continuing operations	2.8	3.0	(0.2)	-4.6%	5.8	5.5	0.3	4.8%
Discontinued operations:								
Income from operations of discontinued business segment	0.0	1.5	(1.5)	-100.0%	0.0	3.3	(3.3)	-100.0%
Income taxes from discontinued operations	0.0	0.6	(0.6)	-100.0%	0.0	1.3	(1.3)	-100.0%
Income from discontinued operations	0.0	0.9	(0.9)	-100.0%	0.0	2.0	(2.0)	-100.0%
Net income	\$2.8	\$3.9	(\$1.1)	-27.2%	\$5.8	\$7.5	(\$1.7)	-23.2%
Earnings per average common share (EPS)	\$1.23	\$1.69	(\$0.46)	-27.2%	\$2.50	\$3.25	\$ (0.75)	-23.1%
EPS attributed to continuing operations	\$1.23	\$1.29	(\$0.06)	-4.6%	\$2.50	\$2.38	\$ 0.12	5.0%
EPS attributed to discontinued operations	\$0.00	\$0.40	(\$0.40)	-100.0%	\$0.00	\$0.87	\$ (0.87)	-100.0%

## Consolidated Balance Sheets—Unaudited

At June 30,	2014	2013
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 11,930,580	\$ 3,393,175
Investment securities	9,847,450	399,099
Accounts receivable, net of allowance for doubtful accounts	8,259,105	8,254,360
Escrow receivable from wireless sale	2,350,156	-
Materials and supplies	1,721,705	4,639,647
Prepayments	1,324,544	1,529,866
Income taxes recoverable	562,920	2,423,604
Deferred income taxes	715,611	1,196,986
Assets held for sale, net of liabilities	-	10,128,837
Total current assets	36,712,071	31,965,574
Property, plant, and equipment	469,924,566	460,221,618
Less accumulated depreciation	327,062,167	314,306,333
Property, plant, and equipment, net	142,862,399	145,915,285
Other assets:		
Investment securities	4,772,217	4,311,359
Investments in unconsolidated entities	8,389,380	9,567,601
Intangibles, net of amortization	16,755,833	18,052,300
Goodwill	27,232,656	27,232,656
Other noncurrent assets	1,331,863	1,353,894
Total other assets	58,481,949	60,517,810
Total assets	\$ 238,056,419	\$ 238,398,669
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Current maturities of bank note	\$ 5,500,000	\$ 5,500,000
Accounts payable and payroll withholdings	2,404,797	2,833,423
Advance billings and customer deposits	3,763,357	3,357,295
Income taxes payable	873,475	184,196
Accrued expenses	12,607,898	5,154,203
Accrued taxes	945,193	965,406
Total current liabilities	26,094,720	17,994,523
Other liabilities:		
Bank note, net of current maturities	44,000,000	49,500,000
Deferred income taxes	31,826,228	21,093,726
Accrued pension benefits	13,082,088	42,796,696
Accrued postretirement benefits	604,047	1,522,487
Other liabilities and deferred credits	707,516	777,217
Total other liabilities	90,219,879	115,690,126
Total liabilities	116,314,599	133,684,649
Stockholders' equity:		
Preferred stock	1,946,300	1,961,400
Common stock	11,415,775	11,446,125
Paid in capital	47,324	47,422
Retained earnings	121,726,634	117,338,522
Accumulated other comprehensive loss	(13,394,213)	(26,079,449)
Total stockholders' equity	121,741,820	104,714,020
Total liabilities and stockholders' equity	\$ 238,056,419	\$ 238,398,669

## Consolidated Statements of Net Income with Discontinued Operations—Unaudited

Six Months Ended June 30,	2014	2013
<b>Operating revenues:</b>		
Residential broadband	\$ 12,107,103	\$ 10,730,514
Business wireline	12,234,522	12,197,095
Data center	6,337,587	5,854,483
Total strategic	<u>30,679,212</u>	<u>28,782,092</u>
Residential legacy telecom	7,056,423	7,683,843
Wholesale	6,731,676	7,056,355
Advertising and search	1,401,424	1,651,349
Total operating revenues	<u>45,868,735</u>	<u>45,173,639</u>
Less uncollectible revenue	1,087,575	894,226
Net operating revenues	<u>44,781,160</u>	<u>44,279,413</u>
<b>Cost of sales and service:</b>		
General support	2,830,769	2,454,619
Central office	4,241,348	4,553,605
Communication termination	5,097,345	5,122,780
Cable and wire facilities	2,098,172	2,127,177
Network operations	3,736,310	3,713,638
Total cost of sales and service	<u>18,003,944</u>	<u>17,971,819</u>
Gross margin	26,777,216	26,307,594
Depreciation and amortization expense	9,531,990	9,280,839
<b>Selling, general, and administrative expense:</b>		
Customer operations	7,498,607	7,505,193
Corporate operations	3,265,423	3,459,778
Taxes, other than income taxes	686,136	648,040
Total selling, general, and administrative expense	<u>11,450,166</u>	<u>11,613,011</u>
Net operating income	5,795,060	5,413,744
<b>Nonoperating income (expense):</b>		
Interest income	75,505	27,395
Interest expense, net of capitalized interest	(507,209)	(507,284)
Equity in earnings of unconsolidated entities	3,960,327	3,602,108
Net gain (loss) on sale of investment securities	(1,083)	-
Other income (expense), net	59,931	310,216
Net nonoperating income	<u>3,587,471</u>	<u>3,432,435</u>
Income from continuing operations before income taxes	9,382,531	8,846,179
Income taxes from continuing operations	3,623,431	3,352,908
Income from continuing operations	<u>5,759,100</u>	<u>5,493,271</u>
<b>Discontinued operations:</b>		
Income from operations of discontinued business segment	-	3,264,395
Income taxes from discontinued operations	-	1,258,554
Income from discontinued operations	<u>-</u>	<u>2,005,841</u>
Net income	5,759,100	7,499,112
Preferred stock dividends	46,185	46,561
Net income available to common stockholders	<u>\$ 5,712,915</u>	<u>\$ 7,452,551</u>
Total earnings per average common share	\$2.50	\$3.25
Earnings per average common attributed to continuing operations	\$2.50	\$2.38
Earnings per average common attributed to discontinued operations	\$0.00	\$0.87
Dividends per common share	\$2.60	\$2.60
Weighted average common shares outstanding	2,283,691	2,290,724

## Consolidated Statements of Comprehensive Income—Unaudited

Six Months Ended June 30,	2014	2013
Net income	\$ 5,759,100	\$ 7,499,112
Other comprehensive income, net of tax:		
Unrealized holding gains arising during the period, net of tax expense in 2014 of \$63,483 and tax expense in 2013 of \$58,669	99,738	89,919
Other comprehensive income, net of tax	99,738	89,919
Comprehensive income	\$ 5,858,838	\$ 7,589,031



## Consolidated Statements of Stockholders' Equity—Unaudited

Six Months Ended June 30,	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)	(17,440)	1,764					(19,876)
Net income				7,499,112				7,499,112
Preferred stock dividends				(46,561)				(46,561)
Common stock dividends				(5,957,393)				(5,957,393)
Acquisition of common stock in excess of stated value				(240,680)				(240,680)
Unrealized gain on marketable securities, net of tax expense						89,919	89,919	89,919
Balance, June 30, 2013	\$ 1,961,400	\$ 11,446,125	\$ 47,422	\$ 117,338,522	\$ (26,160,721)	\$ 81,272	\$ (26,079,449)	\$ 104,714,020
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	-	(7,715)	-					(7,715)
Net income				5,759,100				5,759,100
Preferred stock dividends				(46,185)				(46,185)
Common stock dividends				(5,938,290)				(5,938,290)
Acquisition of common stock in excess of stated value				(95,924)				(95,924)
Unrealized gain on marketable securities, net of tax expense						99,738	99,738	99,738
Balance, June 30, 2014	\$ 1,946,300	\$ 11,415,775	\$ 47,324	\$ 121,726,634	\$ (13,791,294)	\$ 397,081	\$ (13,394,213)	\$ 121,741,820

## Consolidated Statements of Cash Flows—Unaudited

Six Months Ended June 30,	2014	2013
Cash flows from operating activities:		
Net income	\$ 5,759,100	\$ 7,499,112
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	9,531,990	9,837,376
Loss on sale of investment securities	1,083	-
Donated land	-	372,414
Loss on sale, disposal, and abandonment of other assets	162,747	140,585
Equity in earnings of unconsolidated entities	(3,960,327)	(3,602,108)
Deferred income taxes	113,463	624,529
Deferred pension and postretirement benefits	(221,700)	1,260,248
Changes in operating assets and liabilities:		
Accounts receivable	799,191	646,587
Materials and supplies	54,838	884,068
Other assets	981,753	(1,557,507)
Accounts payable and payroll withholdings	(1,236,550)	(1,207,217)
Accrued expenses	5,089,945	307,893
Other liabilities	(4,646,009)	494,409
Net cash provided by operating activities	12,429,524	15,700,389
Cash flow from investing activities:		
Additions to property, plant, and equipment	(7,035,120)	(7,280,530)
Cost of removal of telephone plant, net of salvage	(43,760)	10,049
Proceeds from sale of investment securities	8,110,000	-
Purchases of investment securities	(4,676,574)	(397,742)
Distributions from unconsolidated entities	4,415,980	3,718,720
Net cash provided by (used in) investing activities	770,526	(3,949,503)
Cash flows from financing activities:		
Principal payments on term loan	(2,750,000)	-
Proceeds (repayments) from revolving credit note, net	-	(6,000,000)
Loan origination fees	-	(5,397)
Acquisition of preferred stock	-	(2,436)
Acquisition of common stock	(103,639)	(258,120)
Cash dividends paid	(5,984,475)	(6,003,954)
Net cash used in financing activities	(8,838,114)	(12,269,907)
Net change in cash and cash equivalents	4,361,936	(519,021)
Cash and cash equivalents at beginning of year	7,568,644	3,912,196
Cash and cash equivalents at end of period	\$ 11,930,580	\$ 3,393,175
Short term investment securities at end of period	\$ 9,847,450	\$ 399,099
Total cash, cash equivalents, and short term investment securities	\$ 21,778,030	\$ 3,792,274
Supplemental cash flow information:		
Cash paid for income taxes	\$ 2,147,966	\$ 3,080,278
Cash paid for interest	\$ 494,216	\$ 539,004

I, Jonathan M. Cage, hereby certify that the accompanying unaudited consolidated balance sheets of North State Telecommunications Corporation and Subsidiaries as of June 30, 2014 and 2013 and the related unaudited consolidated statements of net income, comprehensive income, stockholders' equity, and cash flows for the six 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 25th day of July 2014.



**Jonathan M. Cage**  
VP-Chief Financial Officer

## BOARD OF DIRECTORS

**J. Patrick Harman**—Chairman  
**Royster Tucker III**—Vice Chairman  
**C. Hayden McKenzie**  
**Jonathan M. Cage**  
**William H. Dula**

**David L. Harman**  
**Coulson S. Mucher**  
**Sarah M. Olson**  
**Lizbeth W. Privette**

## OFFICERS

**J. Patrick Harman**  
Chairman

**Lynn Welborn**  
Vice President, Administration

**Royster Tucker III**  
President  
Chief Executive Officer

**Mark Dula**  
Vice President,  
Technology and Operations

**Jonathan Cage**  
Vice President  
Chief Financial Officer

**Richard Worden**  
Vice President,  
Sales and Marketing

## CORPORATE OFFICES

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