

2014
SHAREHOLDER
UPDATE

Q4



TO OUR SHAREHOLDERS:

The fourth quarter of 2014 highlights the progress we are making in the transformation of North State. Strategic revenue for the quarter totaled \$15.3 million and \$60.3 million for the year, increasing more than 16% since 2012.

Our core businesses (fiber-based Internet and entertainment, fiber-based business services, data center and cloud services) have shown consistent growth, serving to offset declines in our legacy services. Today, these digital economy products and services make up 67% of our net operating revenues.

We have embraced the Internet-driven view of the world as the Internet further becomes the driver of the digital way of life and business. Fiber Internet with Gigabit speeds and Fiber TV are currently available to tens of thousands of homes and businesses, and we are aggressively extending our offerings into neighboring cities in the metro Triad Region of North Carolina. Our focus on fiber expansion across the region offers new growth potential as we position North State as a fresh, exciting enabler of the Internet and cloud way of life to more people. We are also expanding our offerings of fiber-based business products, such as Gigabit Internet, data services and IP voice products, across the region.

DataChambers provides added business focus to our Internet view of the world and further geographical expansion as businesses are trending more toward outsourcing their data infrastructure and IT services. With the opening of our third data center coming soon, we will have nearly 150,000 square feet of operational premium data center space.

Much is going on at North State to differentiate our company in the marketplace. We are increasing our relevance and appeal in the Internet-driven world, enabling Internet- and data-driven businesses, and having high impact by contributing in meaningful ways to peoples' lives, to the communities in the region, to our team members, and to our partners and shareholders.



J. Patrick Harman
Chairman



Royster Tucker III
President & CEO



Jonathan M. Cage
Vice President & CFO

2014 FOURTH QUARTER AND YEAR HIGHLIGHTS

- Net operating revenues were \$22.5 million for the quarter, down slightly compared to Q4 2013, and \$89.6 million for the year, up slightly compared to 2013
- Strategic revenues increased 2.6 % for the quarter and 4.8% for the year, compared to the same periods in 2013
- Residential broadband revenues increased 3.1% for the quarter and 8.5% for the year
- Gigabit internet products were launched to thousands of homes and businesses during the quarter
- Data center revenues were flat for the quarter and up 4.8% for the year
- Business wireline revenues increased 3.7% for the quarter and 1.7% for the year
- Broadband revenue from businesses increased 8.1% for the quarter and 10.0% for the year
- IP voice revenues increased 11.4% for the quarter and 19.2% for the year
- Revenues generated from businesses in regional expansion markets grew 22.9% for the quarter and 12.5% for the year
- Revenue from businesses now makes up 62.0% of net operating revenue
- Residential legacy telecom revenue declined slightly for the quarter and 5.4% for the year
- Wholesale revenues declined 19.5% for the quarter and 11.7% for year
- Advertising and search revenue declined 5.6% for the quarter and 7.9% for the year
- Operating income was \$1.5 million for the quarter and \$8.6 million for the year
- Nonoperating income, comprised mostly of our wireless partnership interest, was down 29.6% for the quarter and 4.8% for the year due to lower partnership net income
- Income from continuing operations was \$2.0 million for the quarter, down from \$2.6 million in Q4 2013, and \$10.0 million for the year, down from \$10.5 million in 2013
- Net income for the year was \$10.0 million in 2014 compared to \$18.5 million in 2013, with 2013 reflecting \$8.0 million in income from the sale of our wireless business segment
- Earnings per share from continuing operations were \$0.85 for the quarter and \$4.34 for the year
- Earnings before interest, income taxes, depreciation and amortization (EBITDA) was \$8.0 million in the quarter compared to \$8.7 million in Q4 2013 and \$36.0 million for the year compared to \$50.0 million in 2013
- Net cash from operating activities was \$5.6 million for the quarter and \$19.4 million for the year compared to \$4.8 million and \$23.6 million in 2013, respectively
- Cash distributions from the wireless partnership interest were \$1.4 million for the quarter and \$7.6 million for the year compared to \$2.2 million and \$7.9 million in 2013, respectively
- Total cash generation was \$7.0 million for the quarter, the same as in 2013, and \$27.0 million for the year compared to \$31.5 million in 2013
- Capital expenditures were \$5.5 million for the quarter and \$16.3 million for the year, up from \$13.9 million in 2013, reflecting investments in data centers and fiber expansion into regional expansion markets
- \$3.0 million in dividends were paid in the quarter and \$11.9 million for the year

Summary of Statements of Net Income with Discontinued Operations—Unaudited

Amounts in millions except per share amounts

Year Ended December 31,	Quarters Ended December 31,				Year Ended December 31,			
	2014	2013	Change	% Change	2014	2013	Change	% Change
Net operating revenues (after uncollectibles):								
Residential broadband	\$5.6	\$5.5	\$0.1	3.1%	\$22.7	\$20.9	\$1.8	8.5%
Business wireline	6.4	6.1	0.3	3.7%	24.7	24.3	0.4	1.7%
Data center	3.3	3.3	0.0	0.0%	12.9	12.3	0.6	4.8%
Total strategic	15.3	14.9	0.4	2.6%	60.3	57.5	2.8	4.8%
Residential legacy telecom	3.5	3.5	0.0	-0.9%	13.7	14.4	(0.7)	-5.4%
Wholesale	3.0	3.7	(0.7)	-19.5%	12.8	14.5	(1.7)	-11.7%
Advertising and search	0.7	0.7	0.0	-5.6%	2.8	3.1	(0.3)	-7.9%
Net operating revenue	22.5	22.8	(0.3)	0.0%	89.6	89.5	0.1	0.1%
Operating expense:								
Cost of sales and services	9.0	10.1	(1.1)	-11.0%	35.8	37.1	(1.3)	-3.2%
Selling, general, and administrative	6.9	6.0	0.9	14.6%	25.1	23.9	1.2	4.9%
Depreciation and amortization	5.1	5.0	0.1	1.5%	20.1	19.5	0.6	2.8%
Total operating expense	21.0	21.1	(0.1)	-0.8%	81.0	80.5	0.5	0.6%
Operating income	1.5	1.7	(0.2)	-13.9%	8.6	9.0	(0.4)	-5.0%
Nonoperating income (expense):								
Interest income	0.0	0.0	0.0	10.4%	0.2	0.1	0.1	67.1%
Interest expense	(0.2)	(0.3)	0.1	11.5%	(1.0)	(1.0)	0.0	4.9%
Equity in earnings of unconsolidated entities	1.4	1.9	(0.5)	-27.6%	7.1	7.3	(0.2)	-2.5%
Net gain (loss) on sale of investment securities	0.0	0.0	0.0	100.0%	0.0	0.0	0.0	96.4%
Other income (expense), net	0.0	0.0	0.0	-216.2%	0.1	0.3	(0.2)	-85.8%
Total nonoperating income	1.2	1.6	(0.4)	-29.6%	6.4	6.7	(0.3)	-4.8%
Income from continuing operations before income taxes	2.7	3.3	(0.6)	-21.5%	15.0	15.7	(0.7)	-4.9%
Income taxes from continuing operations	0.7	0.7	0.0	-3.6%	5.0	5.2	(0.2)	-5.4%
Income from continuing operations	2.0	2.6	(0.6)	-26.3%	10.0	10.5	(0.5)	-4.7%
Discontinued operations:								
Income from operations of discontinued business segment	0.0	0.0	0.0		0.0	3.8	(3.8)	-100.0%
Gain on sale of discontinued business segment	0.0	0.0	0.0		0.0	9.2	(9.2)	-100.0%
Income taxes from discontinued operations	0.0	0.0	0.0		0.0	(5.0)	5.0	100.0%
Income from discontinued operations	0.0	0.0	0.0		0.0	8.0	(8.0)	-100.0%
Net income	\$2.0	\$2.6	(\$0.6)	-26.3%	\$10.0	\$18.5	(\$8.5)	-45.9%
Earnings per average common share (EPS)	\$0.85	\$1.16	(\$0.31)	-26.7%	\$4.34	\$8.04	(\$3.70)	-46.0%
EPS attributed to continuing operations	\$0.85	\$1.16	(\$0.31)	-26.7%	\$4.34	\$4.56	(\$0.22)	-4.9%
EPS attributed to discontinued operations	\$0.00	\$0.00	\$0.00		\$0.00	\$3.48	(\$3.48)	-100.0%

Consolidated Balance Sheets—Unaudited

At December 31,	2014	2013
Assets		
Current assets:		
Cash and cash equivalents	\$ 9,869,059	\$ 7,568,644
Investment securities	3,706,634	13,498,327
Accounts receivable, net of allowance for doubtful accounts	7,733,055	9,058,297
Escrow receivable from wireless sale	2,350,156	-
Materials and supplies	1,665,517	1,776,543
Prepayments	1,211,005	1,132,092
Income taxes recoverable	2,995,133	888,647
Deferred income taxes	647,766	675,417
Total current assets	30,178,325	34,597,967
Property, plant, and equipment	476,820,095	465,235,345
Less accumulated depreciation	332,638,486	319,710,593
Property, plant, and equipment, net	144,181,609	145,524,752
Other assets:		
Investment securities	4,733,756	4,626,686
Investments in unconsolidated entities	8,367,724	8,845,033
Intangibles, net of amortization	16,107,600	17,404,067
Goodwill	27,232,656	27,232,656
Other noncurrent assets	1,216,744	3,609,819
Total other assets	57,658,480	61,718,261
Total assets	\$ 232,018,414	\$ 241,840,980
Liabilities and Stockholders' Equity		
Current liabilities:		
Current maturities of bank note	\$ 5,500,000	\$ 5,500,000
Accounts payable and payroll withholdings	6,645,369	4,270,272
Advance billings and customer deposits	3,269,399	3,134,432
Income taxes payable	-	211,046
Accrued expenses	6,934,202	8,896,054
Accrued taxes	265,298	229,520
Total current liabilities	22,614,268	22,241,324
Other liabilities:		
Bank note, net of current maturities	41,250,000	46,750,000
Deferred income taxes	26,656,421	31,609,088
Accrued pension benefits	32,103,667	17,540,316
Accrued postretirement benefits	836,566	973,751
Other liabilities and deferred credits	655,912	755,405
Total other liabilities	101,502,566	97,628,560
Total liabilities	124,116,834	119,869,884
Stockholders' equity:		
Preferred stock	1,915,200	1,946,300
Common stock	11,395,825	11,423,490
Paid in capital	53,936	47,324
Retained earnings	119,745,974	122,047,933
Accumulated other comprehensive loss	(25,209,355)	(13,493,951)
Total stockholders' equity	107,901,580	121,971,096
Total liabilities and stockholders' equity	\$ 232,018,414	\$ 241,840,980

Consolidated Statements of Net Income with Discontinued Operations—Unaudited

Year Ended December 31,	2014	2013
Operating revenues:		
Residential broadband	\$ 24,061,273	\$ 22,401,832
Business wireline	25,028,736	24,484,250
Data center	12,899,218	12,304,554
Total strategic	61,989,227	59,190,636
Residential legacy telecom	13,993,481	15,068,731
Wholesale	12,764,708	14,455,482
Advertising and search	2,833,654	3,169,896
Total operating revenues	91,581,070	91,884,745
Less uncollectible revenue	1,942,757	2,300,375
Net operating revenues	89,638,313	89,584,370
Cost of sales and service:		
General support	5,585,172	5,425,452
Central office	8,455,237	9,097,963
Communication termination	10,860,815	10,909,342
Cable and wire facilities	3,438,670	3,921,844
Network operations	7,524,065	7,708,926
Total cost of sales and service	35,863,959	37,063,527
Gross margin	53,774,354	52,520,843
Depreciation and amortization expense	20,077,781	19,534,969
Selling, general, and administrative expense:		
Customer operations	15,894,910	15,569,000
Corporate operations	7,810,854	6,956,321
Taxes, other than income taxes	1,379,083	1,394,645
Total selling, general, and administrative expense	25,084,847	23,919,966
Net operating income	8,611,726	9,065,908
Nonoperating income (expense):		
Interest income	162,730	97,387
Interest expense, net of capitalized interest	(992,843)	(1,043,479)
Equity in earnings of unconsolidated entities	7,134,446	7,319,375
Net gain (loss) on sale of investment securities	(1,069)	(29,378)
Other income (expense), net	45,979	323,452
Net nonoperating income	6,349,243	6,667,357
Income from continuing operations before income taxes	14,960,969	15,733,265
Income taxes from continuing operations	4,955,368	5,237,883
Income from continuing operations	10,005,601	10,495,382
Discontinued operations:		
Income from operations of discontinued business segment	-	3,817,597
Gain on sale of discontinued business segment	-	9,208,657
Income taxes from discontinued operations	-	(5,021,800)
Income from discontinued operations	-	8,004,454
Net income	10,005,601	18,499,836
Preferred stock dividends	91,592	92,746
Net income available to common stockholders	\$ 9,914,009	\$ 18,407,090
Total earnings per average common share	\$4.34	\$8.04
Earnings per average common attributed to continuing operations	\$4.34	\$4.56
Earnings per average common attributed to discontinued operations	\$0.00	\$3.48
Dividends per common share	\$5.20	\$5.20
Weighted average common shares outstanding	2,282,331	2,289,248

Consolidated Statements of Comprehensive Income—Unaudited

Year Ended December 31,	2014	2013
Net income	\$ 10,005,601	\$ 18,499,836
Other comprehensive income (loss), net of tax:		
Unrealized holding gains arising during the period, net of tax expense in 2014 of \$62,864 and tax expense in 2013 of \$194,963	109,957	305,990
Retirement plans adjustment, net of tax benefit in 2014 of \$6,820,043 and tax expense in 2013 of \$8,373,673	(11,825,361)	12,369,427
Other comprehensive income (loss), net of tax	(11,715,404)	12,675,417
Comprehensive income (loss)	\$ (1,709,803)	\$ 31,175,253

Consolidated Statements of Stockholders' Equity—Unaudited

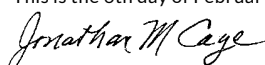
Year Ended December 31,	Preferred Stock	Common Stock	Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income			Total Stockholders' Equity
					Retirement Plans	Marketable Securities	Total	
Balance, January 1, 2013	\$ 1,965,600	\$ 11,463,565	\$ 45,658	\$ 116,084,044	\$ (26,160,721)	\$ (8,647)	\$ (26,169,368)	\$ 103,389,499
Acquisition of stock	(19,300)	(40,075)	1,666					(57,709)
Net income				18,499,836				18,499,836
Preferred stock dividends				(92,746)				(92,746)
Common stock dividends				(11,907,097)				(11,907,097)
Acquisition of common stock in excess of stated value				(536,104)				(536,104)
Current retirement plans adjustment, net of tax expense					12,369,427		12,369,427	12,369,427
Unrealized gain on marketable securities, net of tax expense						305,990	305,990	305,990
Balance, December 31, 2013	\$ 1,946,300	\$ 11,423,490	\$ 47,324	\$ 122,047,933	\$ (13,791,294)	\$ 297,343	\$ (13,493,951)	\$ 121,971,096
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	(31,100)	(27,665)	6,612					(52,153)
Net income				10,005,601				10,005,601
Preferred stock dividends				(91,592)				(91,592)
Common stock dividends				(11,869,627)				(11,869,627)
Acquisition of common stock in excess of stated value				(346,341)				(346,341)
Current retirement plans adjustment, net of tax benefit					(11,825,361)		(11,825,361)	(11,825,361)
Unrealized gain on marketable securities, net of tax expense						109,957	109,957	109,957
Balance, December 31, 2014	\$ 1,915,200	\$ 11,395,825	\$ 53,936	\$ 119,745,974	\$ (25,616,655)	\$ 407,300	\$ (25,209,355)	\$ 107,901,580

Consolidated Statements of Cash Flows—Unaudited

Year Ended December 31,	2014	2013
Cash flows from operating activities:		
Net income	\$ 10,005,601	\$ 18,499,836
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	20,077,781	20,184,296
Change in the allowance for doubtful accounts	(300,000)	(38,000)
Loss on sale of investment securities	1,069	29,378
Donated land	-	372,414
Loss on sale, disposal, and abandonment of other assets	581,213	156,106
Gain on sale of wireless assets	-	(9,208,657)
Equity in earnings of unconsolidated entities	(7,134,446)	(7,319,375)
Deferred income taxes	2,292,935	460,882
Deferred pension and postretirement benefits	(155,138)	1,279,150
Changes in operating assets and liabilities:		
Accounts receivable	1,625,241	(67,395)
Materials and supplies	111,026	3,704,847
Other assets	(3,552,913)	(2,015,108)
Accounts payable and payroll withholdings	2,510,064	(561,494)
Accrued expenses	(2,137,119)	3,340,709
Other liabilities	(4,566,171)	(5,235,676)
Net cash provided by operating activities	<u>19,359,143</u>	<u>23,581,913</u>
Cash flow from investing activities:		
Additions to property, plant, and equipment	(16,320,632)	(13,880,479)
Cost of removal of telephone plant, net of salvage	45,936	(37,702)
Proceeds from sale of wireless assets, net of expenses	-	20,891,389
Proceeds from sale of unconsolidated entities	-	156,627
Proceeds from sale of investment securities	14,140,500	4,260,134
Purchases of investment securities	(4,676,574)	(17,926,081)
Distributions from unconsolidated entities	7,611,755	7,960,385
Net cash provided by investing activities	<u>800,985</u>	<u>1,424,273</u>
Cash flows from financing activities:		
Principal payments on term loan	(5,500,000)	(2,750,000)
Proceeds from line of credit, net of repayments	-	(6,000,000)
Loan origination fees	-	(6,082)
Acquisition of preferred stock	(24,488)	(17,634)
Acquisition of common stock	(374,006)	(576,179)
Cash dividends paid	(11,961,219)	(11,999,843)
Net cash used in financing activities	<u>(17,859,713)</u>	<u>(21,349,738)</u>
Net change in cash and cash equivalents	2,300,415	3,656,448
Cash and cash equivalents at beginning of year	7,568,644	3,912,196
Cash and cash equivalents at end of period	<u>\$ 9,869,059</u>	<u>\$ 7,568,644</u>
Short term investment securities at end of period	<u>\$ 3,706,634</u>	<u>\$ 13,498,327</u>
Total cash, cash equivalents, and short term investment securities	<u>\$ 13,575,693</u>	<u>\$ 21,066,971</u>
Supplemental cash flow information:		
Cash paid for income taxes	\$ 5,440,910	\$ 7,982,834
Cash paid for interest	<u>\$ 969,279</u>	<u>\$ 1,082,179</u>

I, Jonathan M. Cage, hereby certify that the accompanying unaudited consolidated balance sheets of North State Telecommunications Corporation and Subsidiaries as of December 31, 2014 and 2013 and the related unaudited consolidated statements of net income, comprehensive income, stockholders' equity, and cash flows for the nine 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 6th day of February 2015.



Jonathan M. Cage
VP-Chief Financial Officer

BOARD OF DIRECTORS

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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

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Chairman

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Vice President
Chief Administrative Officer

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Vice President
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Jonathan Cage
Vice President
Chief Financial Officer

Richard Worden
Vice President
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CORPORATE OFFICES

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