

2012  
SHAREHOLDER  
UPDATE

Q4



## TO OUR SHAREHOLDERS

Following is our unaudited report of fourth quarter and full year 2012 results highlighted by strong growth in wireline business services, the full year results of DataChambers and growth in wireline residential services. In December, we entered into a definitive agreement for the sale of our wireless operations to AT&T for \$23.5 million in cash. We built our wireless operations from the ground up and are very proud of the value we created in this business. Divesting our wireless segment opens the door for greater flexibility in capital allocation and greater focus on business, consumer broadband and data center services as we continue the transformation of North State to a simpler, more focused company. Closure of the wireless transaction is anticipated by mid-year. While we are exiting the wireless retail business, we continue to participate in wireless through our interest in our Verizon partnership. In accordance with generally accepted accounting standards, wireless is shown as discontinued operations in the 2012 statements and 2011 has been restated for comparative purposes.

We are proud of the effort and results that the North State team produced in 2012. During the year, we implemented cost structure improvements that will strengthen us going forward, invested in data center expansion and grew broadband revenues. Early in the year, we reorganized our management team, realigning a number of internal functions as an integral part of reshaping, simplifying and refreshing North State. Also, we began new approaches to the markets we participate in, simplified our product lines and, in general, altered our marketing approach. As a result of these new directions and in view of the wireless divestiture, we are reporting revenues across the new segments of Business Services, Residential Services, Wholesale Services, and Advertising and Search. The 2012 results include a full year with DataChambers integrated into the company.

Thank you for your continued interest in North State.



**J. Patrick Harman**

Chairman and  
Chief Executive Officer



**Royster Tucker III**

Vice Chairman, President  
and Chief Operating Officer



**Jonathan M. Cage**

Vice President, Chief Financial Officer,  
Secretary and Treasurer

## BUSINESS SERVICES

Business Services include our data center services (DataChambers) and our wireline business services (data services, IP voice, legacy voice, broadband and messaging services). Data Chambers revenues were \$10.6 million for the full year, with steady quarter over quarter growth throughout the year coming across collocation, managed services and cloud service product categories. As we reported previously, we purchased a 50,000 square foot facility in the Raleigh, NC area to expand our data center operations which we anticipate opening in mid-year. DataChambers provides North State increased exposure to the enterprise market and a broader regional, statewide and eastern U.S. footprint.

Wireline business services revenues reached \$23.7 million in 2012, up 5.8% compared to 2011. Average monthly wireline revenue per business customer reached \$370.08 at year end, up 9.8% from 2011 levels. Total business services revenues for 2012 were \$34.4 million, representing 40% of net operating revenues.

## RESIDENTIAL SERVICES

Residential wireline service revenues (Plex Broadband Internet, Plex Advanced TV, Plex Voice and legacy voice services) reached \$33.3 million in 2012, up 9.7% compared to 2011 as broadband gains outpaced declines in residential legacy voice. Average revenue per broadband connection increased 9.8% in 2012 compared to 2011 levels, driven by our ability to meet the growing appetite for faster broadband connections in the home and the growing adoption of Plex Advanced TV as the home entertainment choice made possible by our advanced fiber network. Residential broadband connections reached 30,214 in 2012, up 3% compared to 2011. Average monthly revenue per connected home increased 11% year over year. Residential wireline services represented 39% of net operating revenues at the close of the year.

## WHOLESALE SERVICES

Wholesale services, which include access services and carrier to carrier services, were down 19% in

2012 compared to 2011 largely due to the impacts of intercarrier compensation reform, reductions in access settlement formulas and the decline of legacy voice connections. Wholesale revenues were \$19.7 million in 2012.

## ADVERTISING AND SEARCH

Advertising and search revenues were \$3.2 million in 2012, down 8.7% compared to 2011 as gains in search and online advertising were offset by reductions in print advertising revenues.

## FOURTH QUARTER CONSOLIDATED RESULTS

For the quarter ended December 31, 2012, consolidated net operating revenue from continuing operations totaled \$21.7 million, up 15.6% compared to the year earlier quarter. Operating expenses were \$20.8 million, equal to the previous year fourth quarter. Operating income was \$0.9 million compared to a loss of \$2.0 million. Non-operating income was \$1.0 million for the fourth quarter of 2012 compared to \$1.8 million in the fourth quarter of 2011, the result of an 11.8% decline in equity in earnings of our Verizon partnership during the quarter in addition to \$0.3 million in interest expenses paid in the fourth quarter of 2012.

Fourth quarter 2012 income from continuing operations was \$1.2 million compared to a loss of \$0.1 million in the year earlier quarter. Income from discontinued operations (wireless) was \$0.4 million in the fourth quarter of 2012 compared to \$49,000 in the year earlier quarter. Net income for the fourth quarter 2012 totaled \$1.6 million compared to a loss of \$0.1 million in the year earlier period. Fourth quarter 2012 EBITDA was \$7.3 million compared to \$3.8 million in the fourth quarter of 2011.

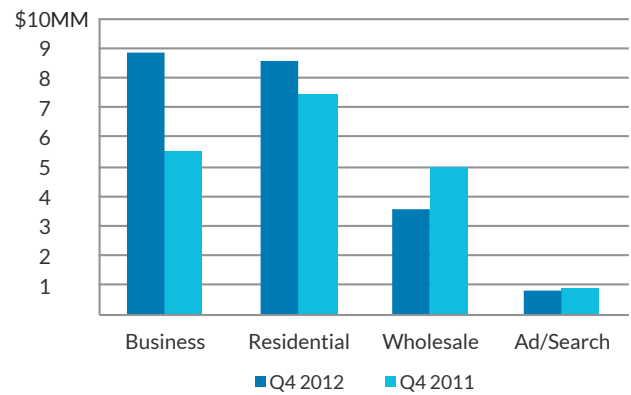
Fourth quarter 2012 cash from operating activities was \$8.2 million compared to \$3.8 million in the year earlier period. Cash distributions from our Verizon partnership were \$1.7 million. Capital expenditures were \$1.6 million compared to \$7.5 million. Free cash flow for the quarter (cash flow from operating activities plus cash flow from the Verizon partnership minus capital expenditures) was \$8.3 million. Dividends paid for the quarter totaled \$9.0 million, including a \$2.60 per share special dividend.

## FULL YEAR RESULTS

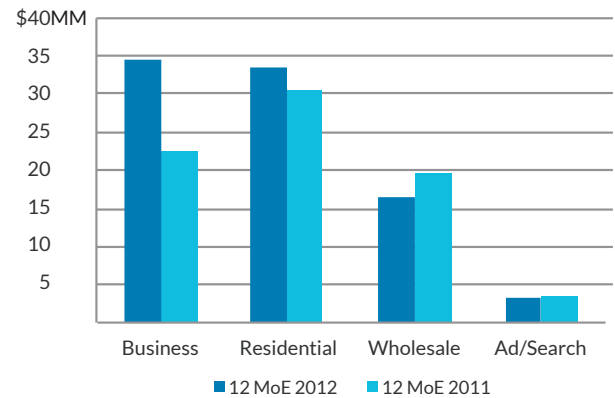
For the full year 2012 compared with 2011, consolidated net operating revenues from continuing operations were \$87.3 million, up 15.1% for the year. Operating expenses were \$81.6 million compared with \$72.1 million. Income from continuing operations was \$6.8 million compared to \$6.3 million. Income from discontinued operations was \$2.3 million, the same level as 2011. Non-operating income totaled \$5.0 million for 2012 compared to \$6.4 million in 2011, the result of a 2.9% increase in equity in earnings of our Verizon partnership, offset by \$1.2 million in interest expense. Net income was \$9.0 million, up from \$8.6 million in 2011. Earnings per share were \$3.90 compared with \$3.71. EBITDA was \$34.8 million in 2012, up 13.2% compared to 2011.

Cash from operating activities was \$29.9 million, up from \$25.2 million in 2011. Cash distributions from our Verizon partnership totaled \$7.6 million for 2012. Capital expenditures were \$27.6 million compared to \$30.0 million. Free cash flow for the year was \$9.9 million. Dividends paid for the year totaled \$18.0 million, including the fourth quarter \$2.60 per share special dividend.

### Q4 2012 vs Q4 2011



### Full Year 2012 vs 2011



## Consolidated Balance Sheets—Unaudited

At December 31,	2012	2011
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 3,912,196	\$ 3,933,244
Investment securities	-	4,570,333
Accounts receivable, net of allowance for doubtful accounts	8,325,897	9,267,473
Materials and supplies	5,517,148	5,846,459
Prepayments	1,459,188	1,354,747
Income taxes recoverable	2,335,098	3,076,802
Deferred income taxes	2,214,938	3,868,179
Assets held for sale, net of liabilities	14,288,523	14,867,882
Total current assets	<u>38,052,988</u>	<u>46,785,119</u>
Property, plant, and equipment	454,390,092	434,989,426
Less accumulated depreciation	<u>307,392,909</u>	<u>294,471,806</u>
Property, plant, and equipment, net	146,997,183	140,517,620
Other assets:		
Investment securities	3,741,865	3,526,922
Investments in unconsolidated entities	9,684,213	11,675,134
Intangibles, net of amortization	18,700,533	19,997,000
Goodwill	27,232,656	27,232,656
Other noncurrent assets	1,326,582	1,460,086
Total other assets	<u>60,685,849</u>	<u>63,891,798</u>
Total assets	<u>\$ 245,736,020</u>	<u>\$ 251,194,537</u>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Revolving credit note	\$ 6,000,000	\$ 2,500,000
Current maturities of long term debt	2,750,000	-
Accounts payable and payroll withholdings	4,150,226	7,567,704
Advance billings and customer deposits	3,075,441	2,868,546
Income taxes payable	286,793	-
Accrued expenses	5,375,264	6,140,131
Accrued taxes	333,855	359,138
Total current liabilities	<u>21,971,579</u>	<u>19,435,519</u>
Other liabilities:		
Bank note, net of current maturities	52,250,000	55,000,000
Deferred income taxes	23,776,553	21,491,690
Accrued pension benefits	42,102,821	37,911,291
Accrued postretirement benefits	1,462,453	1,609,753
Other liabilities and deferred credits	783,115	939,931
Total other liabilities	<u>120,374,942</u>	<u>116,952,665</u>
Total liabilities	<u>142,346,521</u>	<u>136,388,184</u>
Stockholders' equity:		
Preferred stock	1,965,600	1,985,100
Common stock	11,463,565	11,478,450
Paid in capital	45,658	43,718
Retained earnings	116,084,044	125,264,278
Accumulated other comprehensive loss	(26,169,368)	(23,965,193)
Total stockholders' equity	<u>103,389,499</u>	<u>114,806,353</u>
Total liabilities and stockholders' equity	<u>\$ 245,736,020</u>	<u>\$ 251,194,537</u>

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

Years Ended December 31,	2012	2011
Operating revenues:		
Local service	\$ 24,952,974	\$ 25,873,834
Network access	18,998,361	21,991,086
Long distance	3,782,915	3,950,884
Miscellaneous	1,282,744	1,204,859
Legacy telecom	49,016,994	53,020,663
Broadband	26,356,345	21,022,337
Total wireline	75,373,339	74,043,000
Data center	10,634,814	109,590
Advertising and search	3,206,490	3,511,742
Total operating revenues	89,214,643	77,664,332
Less uncollectible revenue	1,903,304	1,804,287
Net operating revenues	87,311,339	75,860,045
Cost of sales and service:		
General support	4,954,150	3,238,178
Central office	11,157,232	10,614,083
Communication termination	11,374,718	8,891,810
Cable and wire facilities	5,678,019	5,306,977
Network operations	7,877,307	5,650,823
Total cost of sales and service	41,041,426	33,701,871
Gross margin	46,269,913	42,158,174
Depreciation and amortization expense	18,022,720	15,817,926
Selling, general, and administrative expense:		
Customer operations	14,737,974	14,457,472
Corporate operations	6,446,986	6,934,832
Taxes, other than income taxes	1,327,702	1,303,195
Total selling, general, and administrative expense	22,512,662	22,695,499
Net operating income	5,734,531	3,644,749
Nonoperating income (expense):		
Interest income	153,731	406,729
Interest expense, net of capitalized interest	(1,209,132)	(13,022)
Equity in earnings of unconsolidated entities	5,675,031	5,514,288
Net gain on sale of investment securities	358,323	411,906
Other income, net	37,580	40,339
Net nonoperating income	5,015,533	6,360,240
Income from continuing operations before income taxes	10,750,064	10,004,989
Income taxes from continuing operations	3,991,648	3,672,107
Income from continuing operations	6,758,416	6,332,882
Discontinued operations:		
Income from operations of discontinued business segment	3,704,289	3,711,943
Income taxes from discontinued operations	1,433,213	1,436,176
Income from discontinued operations	2,271,076	2,275,767
Net income	9,029,492	8,608,649
Preferred stock dividends	93,708	94,981
Net income available to common stockholders	\$ 8,935,784	\$ 8,513,668
Earnings per average common share		
	\$3.90	\$3.71
Weighted average common shares outstanding		
	2,293,779	2,296,746
Dividends per common share		
	\$7.80	\$5.20

## Consolidated Statements of Comprehensive Income—Unaudited

Years Ended December 31,	2012	2011
Net income	\$ 9,029,492	\$ 8,608,649
Other comprehensive income (loss), net of tax:		
Unrealized holding gains arising during the period period, net of tax expense in 2012 of \$87,538 and tax benefit in 2011 of \$27,377	134,161	(38,578)
Retirement plans adjustment, net of tax benefit in 2012 of \$1,354,757 and tax benefit in 2011 of \$6,069,069	(2,338,336)	(9,672,665)
Other comprehensive income (loss), net of tax	(2,204,175)	(9,711,243)
Comprehensive income (loss)	\$ 6,825,317	\$ (1,102,594)

# Consolidated Statements of Stockholders' Equity—Unaudited

Years Ended December 31, 2012 and 2011	Preferred Stock		Common Stock		Paid in Capital		Retained Earnings		Accumulated Other Comprehensive Income		Total Stockholders' Equity	
	Stock		Stock		Capital	Earnings	Retirement Plans	Marketable Securities	Total	Total	Equity	
Balance, January 1, 2011	\$ 2,044,600	\$ 11,486,020	\$ 25,178	\$ 128,806,992	\$ (14,149,720)	\$ (104,230)	\$ (14,253,950)	\$ 128,108,840				
Acquisition of stock	(59,500)	(7,570)	18,540	8,608,649				(48,530)				
Net income				(94,981)				8,608,649				
Preferred stock dividends				(11,943,172)				(94,981)				
Common stock dividends				(113,210)				(11,943,172)				
Acquisition of common stock in excess of stated value								(113,210)				
Current adjustment								(9,672,665)				
Unrealized gain (loss) on marketable securities								(38,578)				
Balance, December 31, 2011	1,985,100	11,478,450	43,718	125,264,278	(23,822,385)	(142,808)	(23,965,193)	114,806,353				
Acquisition of stock	(19,500)	(14,885)	1,940	9,029,492				(32,445)				
Net income				(93,708)				9,029,492				
Preferred stock dividends				(17,889,602)				(93,708)				
Common stock dividends				(226,416)				(17,889,602)				
Acquisition of common stock in excess of stated value								(226,416)				
Current adjustment								(2,338,336)				
Unrealized gain (loss) on marketable securities								134,161				
Balance, December 31, 2012	\$ 1,965,600	\$ 11,463,565	\$ 45,658	\$ 116,084,044	\$ (26,160,721)	\$ (8,647)	\$ (26,169,368)	\$ 103,389,499				



## Consolidated Statements of Cash Flows—Unaudited

Years Ended December 31,	2012	2011
<b>Cash flows from operating activities:</b>		
Net income	\$ 9,029,492	\$ 8,608,649
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	19,180,276	17,044,800
Change in the allowance for doubtful accounts	(60,000)	250,000
Gain on sale of investment securities	(358,323)	(411,906)
Loss on sale, disposal, and abandonment of other assets	300,466	1,052,554
Equity in earnings of unconsolidated entities	(5,675,031)	(5,514,288)
Deferred income taxes	3,415,973	10,348,354
Deferred pension and postretirement benefits	2,006,618	642,022
Changes in operating assets and liabilities:		
Accounts receivable	2,568,807	(114,267)
Inventory	547,342	18,176
Other assets	4,079,657	(569,201)
Accounts payable	(4,640,044)	2,537,367
Accrued expenses	(503,358)	(900,872)
Other liabilities	(19,615)	(7,748,578)
Net cash provided by operating activities	<u>29,872,258</u>	<u>25,242,809</u>
<b>Cash flow from investing activities:</b>		
Additions to property, plant, and equipment	(27,602,331)	(30,035,501)
Cost of removal of telephone plant, net of salvage	(34,462)	(240,973)
Proceeds from sale of investment securities	5,387,084	14,076,045
Purchases of investment securities	(612,207)	(2,879,303)
Investment in the assets of DataChambers, LLC, net of assumed liabilities	-	(55,421,047)
Distributions from equity investments	161,341	-
Distributions from unconsolidated entities	7,553,650	1,743,150
Net cash used in investing activities	<u>(15,146,925)</u>	<u>(72,757,629)</u>
<b>Cash flows from financing activities:</b>		
Proceeds from term loan	-	57,500,000
Proceeds from line of credit, net of repayments	3,500,000	-
Loan origination fees	(4,210)	(314,559)
Acquisition of preferred stock	(17,560)	(40,960)
Acquisition of common stock	(241,301)	(120,780)
Cash dividends paid	(17,983,310)	(12,038,153)
Net cash provided by (used in) financing activities	<u>(14,746,381)</u>	<u>44,985,548</u>
Net change in cash and cash equivalents	(21,048)	(2,529,272)
Cash and cash equivalents at beginning of year	3,933,244	6,462,516
Cash and cash equivalents at end of period	<u>\$ 3,912,196</u>	<u>\$ 3,933,244</u>
Short term investment securities at end of period	<u>\$ -</u>	<u>\$ 4,570,333</u>
Total cash, cash equivalents, and short term investment securities	<u>\$ 3,912,196</u>	<u>\$ 8,503,577</u>
<b>Supplemental cash flow information:</b>		
Cash payments (refunds) of income taxes	<u>\$ (541,867)</u>	<u>\$ (1,953,546)</u>
Cash paid for interest	<u>\$ 1,196,680</u>	<u>\$ 2,926</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, 2012 and 2011 and the related unaudited consolidated statements of net income, comprehensive income, stockholder's equity, and cash flows for the years 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 22nd day of February 2013.



Jonathan M. Cage

VP-CFO, Secretary and Treasurer

## 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

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Chairman and  
Chief Executive Officer

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Vice President,  
Corporate Administration

**Royster Tucker III**  
Vice Chairman, President  
and Chief Operating Officer

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

**Jonathan M. Cage**  
Vice President, Chief Financial Officer,  
Secretary and Treasurer

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

## CORPORATE OFFICES

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