

2013
SHAREHOLDER
UPDATE

Q4



TO OUR SHAREHOLDERS

CHANGES IN OUR EXECUTIVE TEAM

Effective February 6, 2014, Patrick Harman, our Chairman and Chief Executive Officer, stepped down from the role of Chief Executive Officer. Dr. Harman will remain our Chairman of the Board of Directors. With this change, Royster Tucker III was named as our President and Chief Executive Officer. Mr. Tucker III previously served as our President and Chief Operating Officer.

Jim McCarson, our Vice President, Corporate Administration retired at the end of 2013, completing a 42-year career with the organization.

Effective January 1, 2014, Lynn Welborn was promoted to become our Vice President, Administration. A longtime member of the North State team, Mrs. Welborn has served in a variety of roles and management positions, most recently as our Director, External Affairs. In her new position, she will oversee people operations, external affairs, investor relations and additional corporate support and administrative functions.

Q4 2013

The North State team produced a solid fourth quarter in 2013 with continuing operations revenue growth and margin improvement compared to the previous year. Strategic Services—voice and data integrated products for businesses, data center and residential broadband—continue to transform our revenue mix, representing 65% of net operating revenues in the quarter. Income from continuing operations more than doubled in the quarter compared to the same period of last year and was up 55% comparing full year 2013 to 2012.

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 12 months of wireless operations in 2012 and only seven months in 2013.

With the sale of our retail wireless business behind us, 2014 marks the beginning of a new era for North State, establishing a new baseline for an exciting future. We are immersed in delivering the full potential of broadband to the mass market and growing our stellar data center business.

Thank you for your support.



J. Patrick Harman
Chairman



Royster Tucker III
President & CEO



Jonathan M. Cage
Vice President & CFO

Summary of Statements of Net Income with Discontinued Operations—Unaudited

	Quarters Ended December 31				Years Ended December 31			
	2013	2012	Change	% Change	2013	2012	Change	% Change
Net operating revenues (after uncollectibles):								
Residential broadband	\$5.5	\$4.7	\$0.8	16.4%	\$20.9	\$17.6	\$3.3	18.8%
Business wireline	6.1	6.1	0.0	1.0%	24.3	23.8	0.5	2.5%
Data center	3.3	2.7	0.6	20.8%	12.3	10.6	1.7	15.7%
Total strategic	14.9	13.5	1.4	10.3%	57.5	52.0	5.5	10.7%
Residential legacy telecom	3.5	3.8	(0.3)	-9.0%	14.4	15.6	(1.2)	-7.4%
Wholesale	3.7	3.6	0.1	4.7%	14.5	16.6	(2.1)	-12.9%
Advertising and search	0.7	0.8	(0.1)	-7.7%	3.1	3.1	0.0	-0.4%
Net operating revenue	22.8	21.7	1.1	5.4%	89.5	87.3	2.2	2.6%
Operating expense:								
Cost of sales and services	10.1	9.8	0.3	3.1%	37.1	41.1	(4.0)	-9.7%
Selling, general, and administrative	6.0	6.6	(0.6)	-9.5%	23.9	22.5	1.4	6.3%
Depreciation and amortization	5.0	4.5	0.5	12.2%	19.5	18.0	1.5	8.4%
Total operating expense	21.1	20.9	0.2	5.9%	80.5	81.6	(1.1)	-1.3%
Operating income	1.7	0.8	0.9	112.0%	9.0	5.7	3.3	58.1%
Nonoperating income (expense):								
Interest income	0.0	0.0	0.0	38.5%	0.1	0.1	0.0	-36.7%
Interest expense	(0.3)	(0.3)	0.0	-1.2%	(1.0)	(1.2)	0.2	13.7%
Equity in earnings of unconsolidated entities	1.9	1.3	0.6	49.6%	7.3	5.7	1.6	29.0%
Net gain (loss) on sale of investment securities	0.0	0.0	0.0		0.0	0.4	(0.4)	-108.2%
Other income, net	0.0	0.0	0.0	75.2%	0.3	0.0	0.3	760.7%
Total nonoperating income	1.6	1.0	0.6	58.7%	6.7	5.0	1.7	32.9%
Income from continuing operations before income taxes	3.3	1.8	1.5	82.5%	15.7	10.7	5.0	46.4%
Income taxes from continuing operations	0.7	0.7	0.0	4.8%	5.2	4.0	1.2	31.2%
Income from continuing operations	2.6	1.1	1.5	128.2%	10.5	6.7	3.8	55.3%
Discontinued operations:								
Income from operations of discontinued business segment	0.0	0.7	(0.7)	-100.0%	3.8	3.7	0.1	3.1%
Gain on sale of discontinued business segment	0.0	0.0	0.0		9.2	0.0	9.2	
Income taxes from discontinued operations	0.0	0.3	(0.3)	-100.0%	5.0	1.4	3.6	250.4%
Income from discontinued operations	0.0	0.4	(0.4)	-100.0%	8.0	2.3	5.7	252.5%
Net income	\$2.6	\$1.5	\$1.1	66.8%	\$18.5	\$9.0	\$9.5	104.9%
Earnings per average common share (EPS)	\$1.16	\$0.69	\$0.47	70.6%	\$8.04	\$3.90	\$4.14	106.2%
EPS attributed to continuing operations	\$1.16	\$0.51	\$0.65	133.4%	\$4.56	\$2.92	\$1.64	56.3%
EPS attributed to discontinued operations	\$0.00	\$0.18	(\$0.18)	-100.0%	\$3.48	\$0.98	\$2.50	254.6%

Q4 2013 CONSOLIDATED FINANCIAL HIGHLIGHTS

Q4 2013 consolidated net operating revenues from continuing operations were \$22.8 million compared to \$21.7 million in Q4 2012, reflecting increased revenues from strategic services. Total operating expenses for the quarter increased 1.1% compared to Q4 2012. Cost of sales and services were up 3.1%, the result of write-offs related to obsolete inventory, accounting method changes related to set top boxes and increased video content costs. Sales, general and administrative expenses were down 9.5% for the quarter. Depreciation and amortization was \$5.0 million in Q4 2013 compared to \$4.5 million in Q4 2012, due primarily to the effects of a change in accounting method in the treatment of video set top boxes [which had been depreciated when placed in service but are now being depreciated when purchased] in order to better account for the useful life of the assets. Q4 2013 net operating income was \$1.7 million compared to \$0.8 million in Q4 2012. Nonoperating income was \$1.6 million compared to \$1.0 million, reflecting a 49.6% increase in equity in earnings of our Verizon wireless partnership. Income from continuing operations was \$2.7 million compared to \$1.2 million. There was no income from discontinued operations in the fourth quarter of 2013 since the sale of our wireless business segment occurred in July 2013. Net income was \$2.7 million, up 66.8% from Q4 2012. Earnings per share were \$1.16, up from \$0.69. Q4 2013 EBITDA from continuing operations was \$8.7 million compared to \$7.6 million in Q4 2012.

Q4 2013 net cash provided by operating activities was \$4.7 million, down from \$8.2 million Q4 2012, reflecting working capital adjustments and other changes due to pension adjustments. Cash distributions from our Verizon wireless partnership were \$2.2 million in Q4 2013 compared to \$1.7 million in Q4 2012. Capital expenditures were \$4.3 million compared to \$1.6 million in the same quarter of last year, reflecting the completion of fiber build-outs early in 2012. Capital expenditures in 2013 were more evenly distributed

across the four quarters of the year. Free cash flow (cash from operating activities plus cash distributions from Verizon minus capital expenditures) was \$2.6 million in Q4 2013 compared to \$8.3 million in Q4 2012. Cash dividends were \$3.0 million in Q4 2013, compared to \$9.0 million in Q4 2012, which included a special dividend.

2013 FULL-YEAR CONSOLIDATED FINANCIAL HIGHLIGHTS

2013 consolidated net operating revenues from continuing operations were \$89.5 million in, up 2.6% compared to \$87.3 million in 2012. Total operating expenses for the year decreased 1.3%. Operating income was \$9.0 million in 2013 compared to \$5.7 million in 2012. Nonoperating income was \$6.7 million compared to \$5.0 million. Income from continuing operations was \$10.5 million compared to \$6.7 million. Income from discontinued operations was \$8.0 million in 2013, which includes the gain from our wireless asset sale, compared to \$2.3 million in 2012. Net income was \$18.5 million compared to \$9.0 million. Earnings per share were \$8.04 including the wireless gain. Earnings per share attributed to continuing operations were \$4.56 in 2013, up from \$2.92 in 2012. Total EBITDA was \$50 million in 2013 compared to \$34.8 million in 2012. EBITDA from continuing operations was \$36.3 million in 2013 compared to \$30.0 million in 2012.

Net cash provided by operating activities was \$23.6 million in 2013 compared to \$29.9 million in 2012. Cash distributions from our Verizon wireless partnership were \$8.0 million compared to \$7.6 million in 2012. Capital expenditures were \$13.9 million compared to \$27.6 million, reflecting the conclusion of our initial multi-year fiber build-out program in 2012. Free cash flow was \$17.7 million in 2013 compared to \$9.9 million 2012. Cash dividends were \$12.0 million in 2013 compared to \$18.0 million in 2012, which included a special dividend.

NET OPERATING REVENUES

STRATEGIC REVENUES

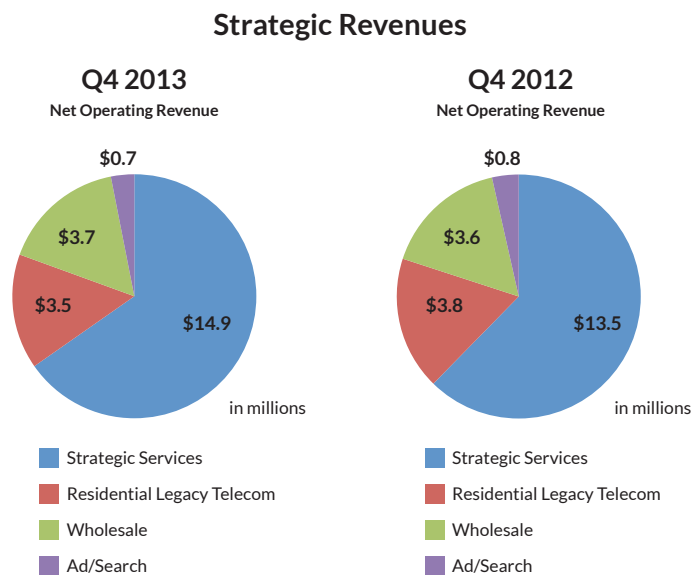
Q4 2013 strategic revenues were \$14.9 million, up 1.4% compared to Q4 2012. Q4 2013 wireline business revenues were \$6.1 million, flat compared to Q4 2012, reflecting higher IP voice sales in Q4 2013, which delivers a monthly recurring revenue stream over time, offset by lower voice system sales in the quarter, where revenue is recognized at the time of sale. Average revenue per wireline business account increased 9% in Q4 2013, reflecting ongoing growth in the adoption of higher bandwidth broadband and data products. Data center revenues generated by wholly owned DataChambers were \$3.3 million in Q4 2013 compared to \$2.7 million in Q4 2012. Full year 2013 wireline business revenues were \$24.3 million, up 2.5% compared to 2012. 2013 Data center revenues were \$12.3 million, up 15.7% compared to 2012. 2013 total strategic revenues were \$57.5 million, up 10.7% compared to 2012.

Q4 2013 residential broadband revenues, which include video and broadband Internet, were \$5.5 million, up 16.4% compared to Q4 2012, the result of growth in total residential broadband connections and a 14% increase in average revenue per residential broadband connection. Residential broadband connections totaled 38,608 at the end of Q4 2013, up 3% from Q4 2012. 2013 full year residential broadband revenues were \$20.9 million, up 18.8% compared to 2012.

RESIDENTIAL LEGACY TELECOM, WHOLESALE, AND ADVERTISING & SEARCH

Q4 2013 residential legacy telecom revenues, generated primarily from basic residential phone services, were \$3.5 million, down 9.0% compared to Q4 2012. Wholesale revenues, generated primarily from access services, were \$3.7 million in Q4 2013, up 4.7% compared to Q4 2012. Advertising and search revenues generated from print yellow page advertising, online advertising and search products were \$0.7 million in Q4 2013 compared to \$0.8 million in the same period of 2012. 2013 full year residential legacy telecom revenues

were \$14.4 million compared to \$15.6 million in 2012. Wholesale revenues were \$14.5 million compared to \$16.6 million, reflecting the impacts of federal reform and lower volumes. Advertising and search revenues were \$3.1 million, down slightly from 2012.



Consolidated Balance Sheets—Unaudited

At December 31,	2013	2012
Assets		
Current assets:		
Cash and cash equivalents	\$ 7,568,644	\$ 3,912,196
Investment securities	13,498,327	-
Accounts receivable, net of allowance for doubtful accounts	9,058,297	8,325,897
Materials and supplies	1,776,543	5,517,148
Prepayments	1,132,092	1,459,188
Income taxes recoverable	888,647	2,335,098
Deferred income taxes	675,417	2,214,938
Assets held for sale, net of liabilities	-	10,923,871
Total current assets	<u>34,597,967</u>	<u>34,688,336</u>
Property, plant, and equipment	465,235,345	454,390,092
Less accumulated depreciation	319,710,593	307,392,909
Property, plant, and equipment, net	<u>145,524,752</u>	<u>146,997,183</u>
Other assets:		
Investment securities	4,626,686	3,741,865
Investments in unconsolidated entities	8,845,033	9,684,213
Intangibles, net of amortization	17,404,067	18,700,533
Goodwill	27,232,656	27,232,656
Other noncurrent assets	3,609,819	1,326,582
Total other assets	<u>61,718,261</u>	<u>60,685,849</u>
Total assets	<u>\$ 241,840,980</u>	<u>\$ 242,371,368</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Revolving credit note	\$ -	\$ 6,000,000
Current maturities of bank note	5,500,000	2,750,000
Accounts payable and payroll withholdings	4,270,272	4,150,226
Advance billings and customer deposits	3,134,432	3,075,441
Income taxes payable	211,046	286,793
Accrued expenses	8,896,054	5,375,264
Accrued taxes	229,520	333,855
Total current liabilities	<u>22,241,324</u>	<u>21,971,579</u>
Other liabilities:		
Bank note, net of current maturities	46,750,000	52,250,000
Deferred income taxes	31,609,088	20,411,901
Accrued pension benefits	17,540,316	42,102,821
Accrued postretirement benefits	973,751	1,462,453
Other liabilities and deferred credits	755,405	783,115
Total other liabilities	<u>97,628,560</u>	<u>117,010,290</u>
Total liabilities	<u>119,869,884</u>	<u>138,981,869</u>
Stockholders' equity:		
Preferred stock	1,946,300	1,965,600
Common stock	11,423,490	11,463,565
Paid in capital	47,324	45,658
Retained earnings	122,047,933	116,084,044
Accumulated other comprehensive loss	(13,493,951)	(26,169,368)
Total stockholders' equity	<u>121,971,096</u>	<u>103,389,499</u>
Total liabilities and stockholders' equity	<u>\$ 241,840,980</u>	<u>\$ 242,371,368</u>

Consolidated Statements of Net Income with Discontinued Operations—Unaudited

Years Ended December 31,	2013	2012
Operating revenues:		
Strategic	\$ 59,190,636	\$ 53,309,190
Residential legacy telecom	15,068,731	16,107,197
Wholesale	14,455,482	16,591,992
Advertising and search	3,169,896	3,206,264
Total operating revenues	91,884,745	89,214,643
Less uncollectible revenue	2,300,375	1,903,304
Net operating revenues	89,584,370	87,311,339
Cost of sales and service:		
General support	5,425,452	4,954,150
Central office	9,097,963	11,157,232
Communication termination	10,909,342	11,374,718
Cable and wire facilities	3,921,844	5,678,019
Network operations	7,708,926	7,877,307
Total cost of sales and service	37,063,527	41,041,426
Gross margin	52,520,843	46,269,913
Depreciation and amortization expense	19,534,969	18,022,720
Selling, general, and administrative expense:		
Customer operations	15,569,000	14,737,974
Corporate operations	6,956,321	6,446,986
Taxes, other than income taxes	1,394,645	1,327,702
Total selling, general, and administrative expense	23,919,966	22,512,662
Net operating income	9,065,908	5,734,531
Nonoperating income (expense):		
Interest income	97,387	153,731
Interest expense, net of capitalized interest	(1,043,479)	(1,209,132)
Equity in earnings of unconsolidated entities	7,319,375	5,675,031
Net gain (loss) on sale of investment securities	(29,378)	358,323
Other income, net	323,452	37,580
Net nonoperating income	6,667,357	5,015,533
Income from continuing operations before income taxes	15,733,265	10,750,064
Income taxes from continuing operations	5,237,883	3,991,648
Income from continuing operations	10,495,382	6,758,416
Discontinued operations:		
Income from operations of discontinued business segment	3,817,597	3,704,289
Gain on sale of discontinued business segment	9,208,657	-
Less: income taxes from discontinued operations	5,021,800	1,433,213
Income from discontinued operations	8,004,454	2,271,076
Net income	18,499,836	9,029,492
Preferred stock dividends	92,746	93,708
Net income available to common stockholders	\$ 18,407,090	\$ 8,935,784
Total earnings per average common share	\$8.04	\$3.90
Earnings per average common attributed to continuing operations	\$4.56	\$2.92
Earnings per average common attributed to discontinued operations	\$3.48	\$0.98
Dividends per common share	\$5.20	\$7.80
Weighted average common shares outstanding	2,289,248	2,293,779

Consolidated Statements of Comprehensive Income—Unaudited

Years Ended December 31,	2013	2012
Net income	\$ 18,499,836	\$ 9,029,492
Other comprehensive income (loss), net of tax:		
Unrealized holding gains arising during the period, net of tax expense in 2013 of \$194,963 and tax expense in 2012 of \$87,538	305,990	134,161
Retirement plans adjustment, net of tax expense in 2013 of \$8,373,673 and tax benefit in 2012 of \$1,354,757	12,369,427	(2,338,336)
Other comprehensive income (loss), net of tax	12,675,417	(2,204,175)
Comprehensive income	\$ 31,175,253	\$ 6,825,317

Consolidated Statements of Stockholders' Equity—Unaudited

Years 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, 2012	\$ 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					(32,445)
Net income				9,029,492				9,029,492
Preferred stock dividends				(93,708)				(93,708)
Common stock dividends				(17,889,602)				(17,889,602)
Acquisition of common stock in excess of stated value				(226,416)				(226,416)
Current retirement plans adjustment, net of tax benefit					(2,338,336)		(2,338,336)	(2,338,336)
Unrealized gain on marketable securities, net of tax expense						134,161	134,161	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
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

Consolidated Statements of Cash Flows—Unaudited

Years Ended December 31,	2013	2012
Cash flows from operating activities:		
Net income	\$ 18,499,836	\$ 9,029,492
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	20,184,296	19,180,276
Change in the allowance for doubtful accounts	(38,000)	(60,000)
Loss (gain) on sale of investment securities	29,378	(358,323)
Donated land	372,414	-
Loss on sale, disposal, and abandonment of other assets	156,106	300,466
Gain on sale of wireless assets	(9,208,657)	-
Equity in earnings of unconsolidated entities	(7,319,375)	(5,675,031)
Deferred income taxes	460,882	3,415,973
Deferred pension and postretirement benefits	1,279,150	2,006,618
Changes in operating assets and liabilities:		
Accounts receivable	(67,395)	2,568,807
Materials and supplies	3,704,847	547,342
Other assets	(2,015,108)	4,079,657
Accounts payable and payroll withholdings	(561,494)	(4,640,044)
Accrued expenses	3,340,709	(503,358)
Other liabilities	(5,235,677)	(19,615)
Net cash provided by operating activities	23,581,913	29,872,258
Cash flow from investing activities:		
Additions to property, plant, and equipment	(13,880,479)	(27,602,331)
Cost of removal of telephone plant, net of salvage	(37,702)	(34,462)
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	4,260,134	5,387,084
Purchases of investment securities	(17,926,081)	(612,207)
Distributions from equity investments	-	161,341
Distributions from unconsolidated entities	7,960,385	7,553,650
Net cash provided by (used in) investing activities	1,424,273	(15,146,925)
Cash flows from financing activities:		
Principal payments on term loan	(2,750,000)	-
Proceeds (repayments) from revolving credit note, net	(6,000,000)	3,500,000
Loan origination fees	(6,082)	(4,210)
Acquisition of preferred stock	(17,634)	(17,560)
Acquisition of common stock	(576,179)	(241,301)
Cash dividends paid	(11,999,843)	(17,983,310)
Net cash used in financing activities	(21,349,738)	(14,746,381)
Net change in cash and cash equivalents	3,656,448	(21,048)
Cash and cash equivalents at beginning of year	3,912,196	3,933,244
Cash and cash equivalents at end of period	\$ 7,568,644	\$ 3,912,196
Short term investment securities at end of period	\$ 13,498,327	\$ -
Total cash, cash equivalents, and short term investment securities	\$ 21,066,971	\$ 3,912,196
Supplemental cash flow information:		
Cash payments (refunds) of income taxes	\$ 7,982,834	\$ (541,867)
Cash paid for interest	\$ 1,082,179	\$ 1,196,680

I, Jonathan M. Cage, hereby certify that the accompanying unaudited consolidated balance sheets of North State Telecommunications Corporation and Subsidiaries as of December 31, 2013 and 2012 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 31st day of January 2014.



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

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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