

2014
SHAREHOLDER
UPDATE

Q3



TO OUR SHAREHOLDERS:

Following is an update of our performance and activities for the third quarter of 2014.

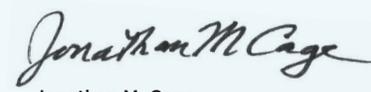
For the third quarter of 2014, strategic revenues, our growth drivers of consumer broadband, wireline business services and data center services, increased 4.9% when compared to the third quarter of 2013. We continue to pass additional homes and businesses with our fiber network, bringing the full potential of the Internet and The Cloud to more people as the Internet becomes more of a lifestyle driver and business success tool. In the third quarter, we launched Gigabit-speed Internet to thousands of homes and businesses. This mass market version of ultrafast Internet, a first to market in the Piedmont Triad region of North Carolina, is a game changer in the Internet-driven world. Our business wireline segment showed continued positive momentum in the quarter with growth from gains in a combination of fiber-based broadband, our flagship Cloud Voice product, and sales of premised based IP voice systems.

We carry two brands under the North State umbrella. The North State brand is our fiber-based wireline businesses, and the DataChambers brand is our data center business. We have crafted a new vision for the North State brand that is rooted in creating remarkable experiences, memorable events and simplicity, and in providing unexpected, positive experiences for our users and in the marketplace. Our vision looks at people, what they want and what they want to do, and it asks how can we get them from where they are to where they want to be in a manner where they feel forever connected to us. We embrace living and working across the Internet and The Cloud, and we see our future in this space. "Cloud enabled" is a new paradigm that combines the power of fiber Internet and the enablement of applications and services in The Cloud with the imagination and desires of people. Our fiber-based approach to delivering products is aligned with the future because we believe that the Internet is just in its infancy as an enabler of transformational change in the world. The DataChambers brand has at its roots stability, security, and scalability, and it is very well respected in the marketplace. Visit www.datachambers.com to get a fresh new perspective on our data center business.

The North State and DataChambers teams work hard every day to support our initiatives and make changes in the organization to support where we are headed. They are engaged in their jobs and the transition of North State to a leader in the Internet-driven world. They are championing many changes as we alter our external feel as well as make internal changes to improve the experience that people have when they explore our brand and engage with us.


J. Patrick Harman
Chairman


Royster Tucker III
President & CEO


Jonathan M. Cage
Vice President & CFO

CONSOLIDATED FINANCIAL HIGHLIGHTS FOR THE QUARTER ENDING SEPTEMBER 30, 2014

Third quarter consolidated net operating revenues from continuing operations were \$22.4 million, the same level as the third quarter of 2013. Revenue gains in strategic services were tempered during the quarter due to credit policy changes that took place in the second quarter, impacting residential broadband gross adds to some degree and increasing churn during the quarter. Operating income for the quarter was \$1.3 million, compared to \$1.8 million in the third quarter of 2013, impacted by increased marketing expense related to our North State brand launch, increased video content costs and higher depreciation expense during the quarter. Non-operating income was \$1.6 million, up slightly from the third quarter of 2013, impacted by a 1.2% decline in equity in earnings of our Alltel/Verizon wireless partnership as the partnership delivered lower net income in the third quarter of 2014 than in the third quarter of 2013. Income from continuing operations was \$2.3 million, down 2%. Net income was \$2.3 million, compared to \$8.3 million (which included the gain on the sale of our wireless business segment). Earnings per share were \$0.99 compared to \$3.63. Earnings per share from continuing operations were \$0.99 compared to \$1.01. EBITDA was \$8.6 million compared to \$18.8 million in 2013.

For the nine months ending September 30, 2014, net operating revenues were \$67.2 million, up .7% from the same period of 2013. Operating income for the period was \$7.1 million, compared to \$7.3 million. Non-operating income was \$5.2 million, up from \$5.0 million. Income from continuing operations was \$8.0 million, up 2.8%. Net income was \$8.0 million, compared to \$15.8 million. Earnings per share were \$3.49, compared to \$6.88. Earnings per share from continuing operations were \$3.49, up from \$3.40. EBITDA was \$28.0 million, compared to \$41.3 million.

Cash provided by operating activities was \$1.4 million in the third quarter of 2014, compared to \$3.1 million in the third quarter of 2013. Cash distributions from our wireless partnership were \$1.7 million, compared

to \$2.0 million as the partnership experienced increased capital spending in the quarter. Capital expenditures were \$3.8 million, compared to \$2.3 million, reflecting increased fiber expansion and higher success-based capital costs in the quarter. Free cash flow (cash provided by operating activities plus cash distributions from our wireless partnership minus capital expenditures) was a negative \$.7 million for the third quarter of 2014, compared to \$2.8 million in the third quarter of 2013. Cash dividends were \$3.0 million, the same amount as the 2013 third quarter.

For the first nine months of the year, cash provided by operating activities was \$13.8 million, compared to \$18.8 million in 2013. Wireless partnership cash distributions were \$6.2 million, compared to \$5.8 million. Capital expenditures were \$10.9 million, compared to \$9.6 million. Free cash flow was \$9.1 million, compared to \$15.0 million. Cash dividends were \$9.0 million, the same amount as in the first nine months of 2013.

NET OPERATING REVENUES STRATEGIC REVENUES

Net operating revenues from strategic services were \$15.1 million in the third quarter of 2014, compared to \$14.4 million in the third quarter of 2013. Residential broadband revenues, derived from Fiber TV, Fiber Internet, Fiber Voice and Basic Internet products, were \$5.6 million in the third quarter of 2014, up 6.5% from the third quarter of 2013, with growth tempered during the quarter to some degree by credit policy changes that took place in the second quarter of the year. Residential broadband revenues were up 10.4% for the first nine months of the year. Business wireline revenues were \$6.3 million during the third quarter of 2014, up 4.2% from the third quarter of 2013, partially driven by a 13% increase in fiber-based broadband and other services sold in our expanded market areas. Business wireline revenues were up 1.0% for the first nine months of the year. Data center revenues generated by wholly owned DataChambers were \$3.2 million in the third quarter of 2014, up from \$3.1 million in the third quarter of 2013. For the first nine months of the year, data center revenues were \$9.6 million, up from \$9.0 million for the first nine months of 2013.

RESIDENTIAL LEGACY TELECOM, WHOLESALÉ, and ADVERTISING & SEARCH

Residential legacy telecom revenues generated primarily from basic residential phone services were \$3.5 million during the third quarter of 2014, down 1.9% compared to the third quarter of 2013, and \$10.2 million for the first nine months of the year, down from \$11.0 million in the first nine months of 2014. Wholesale revenues, generated primarily from access services, were \$3.0 million in the third quarter of 2014, down from \$3.7 million in the third quarter of 2013, and \$9.8 million for the first nine months of 2014, compared to \$10.7 million for the first nine months of 2013. Decreased volumes and regulatory reforms continue to impact this segment. Advertising and search revenues, coming from online and print advertising and online search products, were \$.8 million in the third quarter of 2014, down 5.6% from the third quarter of 2013, and \$2.1 million in the first nine months of 2013, compared to \$2.3 million in the first nine months of 2013.

Summary of Statements of Net Income with Discontinued Operations—Unaudited

Amounts in millions except per share amounts

	Quarter Ended September 30				Nine Months Ended September 30			
	2014	2013	Change	% Change	2014	2013	Change	% Change
Net operating revenues (after uncollectibles):								
Residential broadband	\$5.6	\$5.3	\$0.3	6.5%	\$17.1	\$15.5	\$1.6	10.4%
Business wireline	6.3	6.0	0.3	4.2%	18.4	18.2	0.2	1.0%
Data center	3.2	3.1	0.1	3.5%	9.6	9.0	0.6	6.6%
Total strategic	15.1	14.4	0.7	4.9%	45.1	42.7	2.4	5.6%
Residential legacy telecom	3.5	3.5	0.0	-1.9%	10.2	11.0	(0.8)	-6.8%
Wholesale	3.0	3.7	(0.7)	-17.4%	9.8	10.7	(0.9)	-9.0%
Advertising and search	0.8	0.8	0.0	-5.6%	2.1	2.3	(0.2)	-8.6%
Net operating revenue	22.4	22.4	(0.0)	0.0%	67.2	66.7	0.5	0.7%
Operating expense:								
Cost of sales and services	8.9	9.0	(0.1)	-1.3%	26.9	27.0	(0.1)	-0.3%
Selling, general, and administrative	6.8	6.3	0.5	7.2%	18.2	17.9	0.3	1.6%
Depreciation and amortization	5.4	5.3	0.1	4.1%	15.0	14.5	0.5	3.2%
Total operating expense	21.1	20.6	0.5	2.7%	60.1	59.4	0.7	1.1%
Operating income	1.3	1.8	(0.5)	-31.3%	7.1	7.3	(0.2)	-2.8%
Nonoperating income (expense):								
Interest income	0.0	0.0	0.0	45.1%	0.1	0.1	0.0	108.7%
Interest expense	(0.2)	(0.2)	0.0	7.4%	(0.8)	(0.8)	0.0	2.6%
Equity in earnings of unconsolidated entities	1.8	1.8	0.0	-1.2%	5.8	5.4	0.4	6.2%
Net gain (loss) on sale of investment securities	0.0	0.0	0.0	-97.1%	0.0	0.0	0.0	-325.1%
Other income (expense), net	0.0	0.0	0.0	292.7%	0.1	0.3	(0.2)	-79.4%
Total nonoperating income	1.6	1.6	0.0	1.0%	5.2	5.0	0.2	3.4%
Income from continuing operations before income taxes	2.9	3.4	(0.5)	-16.5%	12.3	12.3	0.0	-0.3%
Income taxes from continuing operations	0.6	1.1	(0.5)	-45.6%	4.3	4.5	(0.2)	-5.7%
Income from continuing operations	2.3	2.3	(0.0)	-2.0%	8.0	7.8	0.2	2.8%
Discontinued operations:								
Income from operations of discontinued business segment	0.0	0.6	(0.6)	-100.0%	0.0	3.8	(3.8)	-100.0%
Gain on sale of discontinued business segment	0.0	9.2	(9.2)	-100.0%	0.0	9.2	(9.2)	-100.0%
Income taxes from discontinued operations	0.0	(3.8)	3.8	100.0%	0.0	(5.0)	5.0	100.0%
Income from discontinued operations	0.0	6.0	(6.0)	-100.0%	0.0	8.0	(8.0)	-100.0%
Net income	\$2.3	\$8.3	(\$6.0)	-72.8%	\$8.0	\$15.8	(\$7.8)	-49.2%
Earnings per average common share (EPS)	\$0.99	\$3.63	(\$2.64)	-72.7%	\$3.49	\$6.88	(\$3.39)	-49.3%
EPS attributed to continuing operations	\$0.99	\$1.01	(\$0.02)	-1.9%	\$3.49	\$3.40	\$0.09	2.8%
EPS attributed to discontinued operations	\$0.00	\$2.62	(\$2.62)	-100.0%	\$0.00	\$3.48	(\$3.48)	-100.0%

Consolidated Balance Sheets—Unaudited

At September 30,	2014	2013
Assets		
Current assets:		
Cash and cash equivalents	\$ 10,130,694	\$ 9,289,793
Investment securities	6,396,045	13,865,158
Accounts receivable, net of allowance for doubtful accounts	8,081,511	8,639,571
Escrow receivable from wireless sale	2,350,156	-
Materials and supplies	2,087,315	2,637,853
Prepayments	1,008,482	1,327,453
Income taxes recoverable	1,087,328	383,908
Deferred income taxes	735,741	1,003,313
Total current assets	<u>31,877,272</u>	<u>37,147,049</u>
Property, plant, and equipment	472,484,472	464,835,625
Less accumulated depreciation	331,052,636	318,638,017
Property, plant, and equipment, net	<u>141,431,836</u>	<u>146,197,608</u>
Other assets:		
Investment securities	4,687,954	4,449,358
Investments in unconsolidated entities	8,453,363	9,363,926
Intangibles, net of amortization	16,431,717	17,728,183
Goodwill	27,232,656	27,232,656
Other noncurrent assets	1,304,019	3,755,633
Total other assets	<u>58,109,709</u>	<u>62,529,756</u>
Total assets	<u>\$ 231,418,817</u>	<u>\$ 245,874,413</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Current maturities of bank note	\$ 5,500,000	\$ 5,500,000
Accounts payable and payroll withholdings	3,504,285	2,840,381
Advance billings and customer deposits	3,354,924	3,311,329
Income taxes payable	-	693,198
Accrued expenses	6,950,493	4,994,199
Accrued taxes	1,134,708	1,161,023
Total current liabilities	<u>20,444,410</u>	<u>18,500,130</u>
Other liabilities:		
Bank note, net of current maturities	42,625,000	48,125,000
Deferred income taxes	31,474,795	23,801,518
Accrued pension benefits	14,779,939	43,393,375
Accrued postretirement benefits	597,045	1,155,579
Other liabilities and deferred credits	703,823	774,268
Total other liabilities	<u>90,180,602</u>	<u>117,249,740</u>
Total liabilities	<u>110,625,012</u>	<u>135,749,870</u>
Stockholders' equity:		
Preferred stock	1,915,200	1,946,300
Common stock	11,402,360	11,443,285
Paid in capital	53,936	47,324
Retained earnings	120,851,670	122,631,501
Accumulated other comprehensive loss	(13,429,361)	(25,943,867)
Total stockholders' equity	<u>120,793,805</u>	<u>110,124,543</u>
Total liabilities and stockholders' equity	<u>\$ 231,418,817</u>	<u>\$ 245,874,413</u>

Consolidated Statements of Net Income with Discontinued Operations—Unaudited

Nine Months Ended September 30,	2014	2013
Operating revenues:		
Residential broadband	\$ 18,205,486	\$ 16,508,849
Business wireline	18,628,236	18,239,579
Data center	9,577,718	8,984,881
Total strategic	46,411,440	43,733,309
Residential legacy telecom	10,622,515	11,410,869
Wholesale	9,755,552	10,716,025
Advertising and search	2,159,528	2,451,504
Total operating revenues	68,949,035	68,311,707
Less uncollectible revenue	1,761,528	1,583,673
Net operating revenues	67,187,507	66,728,034
Cost of sales and service:		
General support	4,168,797	3,747,666
Central office	6,309,879	6,742,602
Communication termination	7,946,985	7,712,176
Cable and wire facilities	2,811,156	3,055,014
Network operations	5,663,046	5,731,672
Total cost of sales and service	26,899,863	26,989,130
Gross margin	40,287,644	39,738,904
Depreciation and amortization expense	14,967,322	14,501,192
Selling, general, and administrative expense:		
Customer operations	11,477,057	11,647,974
Corporate operations	5,728,461	5,288,094
Taxes, other than income taxes	1,026,998	1,006,472
Total selling, general, and administrative expense	18,232,516	17,942,540
Net operating income	7,087,806	7,295,172
Nonoperating income (expense):		
Interest income	117,253	56,177
Interest expense, net of capitalized interest	(759,590)	(779,807)
Equity in earnings of unconsolidated entities	5,767,460	5,432,108
Net gain (loss) on sale of investment securities	(1,069)	475
Other income, net	63,516	308,355
Net nonoperating income	5,187,570	5,017,308
Income from continuing operations before income taxes	12,275,376	12,312,480
Income taxes from continuing operations	4,252,520	4,509,010
Income from continuing operations	8,022,856	7,803,470
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	8,022,856	15,807,924
Preferred stock dividends	46,185	46,561
Net income available to common stockholders	\$ 7,976,671	\$ 15,761,363
Total earnings per average common share	\$3.49	\$6.88
Earnings per average common attributed to continuing operations	\$3.49	\$3.40
Earnings per average common attributed to discontinued operations	\$0.00	\$3.48
Dividends per common share	\$3.90	\$3.90
Weighted average common shares outstanding	2,283,096	2,290,109

Consolidated Statements of Comprehensive Income—Unaudited

Nine Months Ended September 30,	2014	2013
Net income	\$ 8,022,856	\$ 15,807,924
Other comprehensive income, net of tax:		
Unrealized holding gains arising during the period, net of tax expense in 2014 of \$41,102 and tax expense in 2013 of \$147,134	64,590	225,501
Other comprehensive income, net of tax	64,590	225,501
Comprehensive income	\$ 8,087,446	\$ 16,033,425

Consolidated Statements of Stockholders' Equity—Unaudited

Nine Months Ended September 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	(19,300)	(20,280)	1,666					(37,914)
Net income				15,807,924				15,807,924
Preferred stock dividends				(46,561)				(46,561)
Common stock dividends				(8,933,386)				(8,933,386)
Acquisition of common stock in excess of stated value				(280,520)				(280,520)
Unrealized gain on marketable securities, net of tax expense						225,501	225,501	225,501
Balance, September 30, 2013	\$ 1,946,300	\$ 11,443,285	\$ 47,324	\$ 122,631,501	\$ (26,160,721)	\$ 216,854	\$ (25,943,867)	\$ 110,124,543
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)	(21,130)	6,612					(45,618)
Net income				8,022,856				8,022,856
Preferred stock dividends				(46,185)				(46,185)
Common stock dividends				(8,905,013)				(8,905,013)
Acquisition of common stock in excess of stated value				(267,921)				(267,921)
Unrealized gain on marketable securities, net of tax expense						64,590	64,590	64,590
Balance, September 30, 2014	\$ 1,915,200	\$ 11,402,360	\$ 53,936	\$ 120,851,670	\$ (13,791,294)	\$ 361,933	\$ (13,429,361)	\$ 120,793,805

Consolidated Statements of Cash Flows—Unaudited

Nine Months Ended September 30,	2014	2013
Cash flows from operating activities:		
Net income	\$ 8,022,856	\$ 15,807,924
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	14,967,322	15,150,519
Change in the allowance for doubtful accounts	-	(38,000)
Loss (gain) on sale of investment securities	1,069	(475)
Donated land	-	372,414
Loss on sale, disposal, and abandonment of other assets	548,546	204,536
Gain on sale of wireless assets	-	(9,208,657)
Equity in earnings of unconsolidated entities	(5,767,460)	(5,432,108)
Deferred income taxes	144,076	(216,204)
Deferred pension and postretirement benefits	(127,325)	1,893,472
Changes in operating assets and liabilities:		
Accounts receivable	976,786	351,331
Materials and supplies	(310,773)	2,652,782
Other assets	560,006	(1,994,937)
Accounts payable and payroll withholdings	(545,496)	(1,814,487)
Accrued expenses	(1,251,419)	852,509
Other liabilities	(3,433,486)	250,119
Net cash provided by operating activities	<u>13,784,702</u>	<u>18,830,738</u>
Cash flow from investing activities:		
Additions to property, plant, and equipment	(10,863,015)	(9,580,447)
Cost of removal of telephone plant, net of salvage	57,044	26,919
Proceeds from sale of wireless assets, net of expenses	-	20,891,389
Proceeds from sale of investment securities	11,490,500	105,134
Purchases of investment securities	(4,676,574)	(13,969,068)
Distributions from unconsolidated entities	6,159,130	5,752,395
Net cash provided by (used in) investing activities	<u>2,167,085</u>	<u>3,226,322</u>
Cash flows from financing activities:		
Principal payments on term loan	(4,125,000)	(1,375,000)
Proceeds (repayments) from revolving credit note, net	-	(6,000,000)
Loan origination fees	-	(6,082)
Acquisition of preferred stock	(24,488)	(17,634)
Acquisition of common stock	(289,051)	(300,800)
Cash dividends paid	(8,951,198)	(8,979,947)
Net cash used in financing activities	<u>(13,389,737)</u>	<u>(16,679,463)</u>
Net change in cash and cash equivalents	2,562,050	5,377,597
Cash and cash equivalents at beginning of year	7,568,644	3,912,196
Cash and cash equivalents at end of period	<u>\$ 10,130,694</u>	<u>\$ 9,289,793</u>
Short term investment securities at end of period	<u>\$ 6,396,045</u>	<u>\$ 13,865,158</u>
Total cash, cash equivalents, and short term investment securities	<u>\$ 16,526,739</u>	<u>\$ 23,154,951</u>
Supplemental cash flow information:		
Cash paid for income taxes	<u>\$ 4,897,966</u>	<u>\$ 6,256,674</u>
Cash paid for interest	<u>\$ 732,612</u>	<u>\$ 812,347</u>

I, Jonathan M. Cage, hereby certify that the accompanying unaudited consolidated balance sheets of North State Telecommunications Corporation and Subsidiaries as of September 30, 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 24th day of October 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

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Chairman

Lynn Welborn
Vice President
Chief Administrative Officer

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President
Chief Executive Officer

Mark Dula
Vice President
Chief Operating Officer

Jonathan Cage
Vice President
Chief Financial Officer

Richard Worden
Vice President
Chief Business Officer

CORPORATE OFFICES

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