

2015  
SHAREHOLDER  
UPDATE

Q2



## TO OUR SHAREHOLDERS:

Following is our update of North State's financial results for the three-month and six-month periods that ended June 30, 2015. The second quarter of the year was highlighted by the announcement of our acquisition of Stalwart Systems Group, Inc.—a leading Charlotte, N.C.-based IT and security integrator. North State's key overriding purpose is to have a high impact by inspiring people to live their lives and run their businesses across the Internet and in the cloud. Running a business today and taking steps to leverage the Internet and the cloud is complex. Design, integration, execution and management of IT infrastructure and security are key elements to running an Internet- and data-driven business. Stalwart's skills in these areas open up new ways for us to live out our purpose of making businesses better in today's digital world. In blending Stalwart's security, IT and managed services strengths with the infrastructure and cloud capabilities of our DataChambers subsidiary, we have fashioned a unique enabler of next generation services in the enterprise and large business market in the southeastern US. The acquisition gives us greater scope with new product offerings, new areas of focus and strong relevance in the evolving data-centric world as well as increases our scale as we become a larger more geographically diverse organization—all key components to our long-term growth path. We anticipate closing on the Stalwart transaction in the third quarter of this year. [Click here](#) to view our press release announcing the Stalwart acquisition.

For the second quarter of 2015, strategic revenues were \$16.1 million, up 5.7% from \$15.3 million in the second quarter of 2014. Residential broadband revenues were up 3% for the quarter, driven by increased average revenue per user as people migrate to our Gigabit Internet product to fulfill their Internet-driven lives. Business wireline revenues were up 3.3% with gains coming in our fiber-focused expansion markets and IP voice offerings. Data center revenues increased 15.2% compared to the second quarter of 2014, with gains in collocation and cloud services. Our key strategic initiatives comprised nearly 70% of our net operating revenues for the quarter.

## CONSOLIDATED FINANCIAL HIGHLIGHTS FOR THE THREE MONTHS ENDING JUNE 30, 2015

Consolidated net operating revenues for the second quarter of 2015 were \$23.3 million, up 3.7% from the second quarter of 2014. Operating expenses were up 12.6% for the quarter due to absorbing allocated costs related to our wireless operations, which were covered by transition services payments in the second quarter of 2014, along with increased costs associated with growth in our fiber products and data center expansion. Operating income for the quarter was \$1.1 million compared to \$2.7 million. Nonoperating income was \$1.9 million, equal to the same period of 2014. EBITDA was \$8.3 million compared to \$9.6 million. Net income was \$1.9 million compared to \$2.8 million. Earnings per share were \$0.83 compared to \$1.23.

Cash flows from operating activities were \$1.3 million in the second quarter of 2015 compared to \$3.9 million in the second quarter of 2014—the result of lower net income for the quarter and working capital adjustments. Capital expenditures were \$5 million, up from \$2.9 million due to increased investments in fiber build-outs, increased success-based costs associated with adding new fiber customers and data center expansion. Cash distributions from our wireless partnership were \$1.7 million, down from \$2.3 million as the partnership increased capital spending during the quarter. Free cash flow was negative \$2 million compared to \$3.3 million. Dividends paid were \$3 million, the same as the second quarter of 2014.

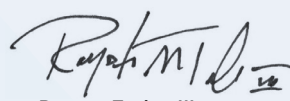
### **CONSOLIDATED FINANCIAL HIGHLIGHTS FOR THE SIX MONTHS ENDING JUNE 30, 2015**

For the first six months of 2015, strategic net operating revenues totaled \$31.5 million, up 5.1% from the first six months of 2014. Residential broadband net operating revenues were \$11.8 million, up 2.7%. Business wireline net operating revenues were \$12.6 million, up from \$12.1 million. Data center net operating revenues were \$7.1 million, up 11.7%.

Consolidated net operating revenues were \$45.8 million, up 2.4% from the first six months of 2014. Operating income was \$3 million compared to \$5.8 million. Nonoperating income was \$4 million compared to \$3.6 million. EBITDA was \$16.9 million compared to \$19.4 million. Net income was \$4.4 million compared to \$5.8 million. Earnings per share were \$1.91 compared to \$2.50.

For the first six months of 2015, cash flows from operating activities were \$8 million, down from \$12.4 million for the first six months of 2014. Capital expenditures were \$13 million, up from \$7 million. Wireless partnership cash distributions were \$3.2 million compared to \$4.4 million in 2014. Free cash flow was negative \$1.8 million. Dividends paid were \$6 million, the same amounts paid in the first six months of 2014.

  
J. Patrick Harman  
Chairman

  
Royster Tucker III  
President & CEO

  
Jonathan M. Cage  
Vice President & CFO

## Summary of Statements of Net Income—Unaudited

Amounts in millions except per share amounts

	Quarter Ended June 30,				Six Months Ended June 30,			
	2015	2014	Change	% Change	2015	2014	Change	% Change
Net operating revenues (after uncollectibles):								
Residential broadband	\$6.1	\$5.9	\$0.2	3.0%	\$11.8	\$11.5	\$0.3	2.7%
Business wireline	6.4	6.2	0.2	3.3%	12.6	12.1	0.5	4.0%
Data center	3.6	3.2	0.4	15.2%	7.1	6.3	0.8	11.7%
Total strategic	16.1	15.3	0.8	5.7%	31.5	29.9	1.6	5.1%
Residential legacy telecom	3.1	3.2	(0.1)	-5.3%	6.4	6.7	(0.3)	-5.1%
Wholesale	3.4	3.3	0.1	4.0%	6.6	6.7	(0.1)	-1.7%
Advertising and search	0.7	0.6	0.1	2.7%	1.3	1.4	(0.1)	-0.7%
Net operating revenue	23.3	22.4	0.9	3.7%	45.8	44.7	1.1	2.4%
Operating expense:								
Cost of sales and services	9.8	9.0	0.8	9.0%	19.1	18.0	1.1	6.0%
Selling, general, and administrative	7.4	5.9	1.5	25.1%	14.3	11.4	2.9	24.8%
Depreciation and amortization	5.0	4.8	0.2	3.7%	9.4	9.5	(0.1)	-1.2%
Total operating expense	22.2	19.7	2.5	12.6%	42.8	38.9	3.9	9.8%
Operating income	1.1	2.7	(1.6)	-59.2%	3.0	5.8	(2.8)	-47.4%
Nonoperating income (expense):								
Interest income	0.0	0.0	0.0	-28.8%	0.1	0.1	0.0	-20.7%
Interest expense	(0.3)	(0.2)	(0.1)	-2.5%	(0.5)	(0.5)	0.0	5.2%
Equity in earnings of unconsolidated entities	2.1	2.0	0.1	3.2%	4.3	3.9	0.4	8.2%
Net gain (loss) on sale of investment securities	0.0	0.0	0.0		0.0	0.0	0.0	981.3%
Other income (expense), net	0.1	0.1	0.0	76.1%	0.1	0.1	0.0	49.6%
Total nonoperating income	1.9	1.9	0.0	4.4%	4.0	3.6	0.4	10.5%
Income before income taxes	3.0	4.6	(1.6)	-33.5%	7.0	9.4	(2.4)	-25.3%
Income taxes	1.1	1.8	(0.7)	-35.6%	2.6	3.6	(1.0)	-28.1%
Net income	\$1.9	\$2.8	(\$0.9)	-32.2%	\$4.4	\$5.8	(\$1.4)	-23.5%
Earnings per average common share (EPS)	\$0.83	\$1.23	(\$0.40)	-32.5%	\$1.91	\$2.50	(\$0.59)	-23.6%

## Consolidated Balance Sheets—Unaudited

At June 30,	2015	2014
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 4,951,645	\$ 11,930,580
Investment securities	-	9,847,450
Accounts receivable, net of allowance for doubtful accounts	7,845,819	8,259,105
Escrow receivable from wireless sale	-	2,350,156
Materials and supplies	2,158,541	1,721,705
Prepayments	1,926,031	1,324,544
Income taxes recoverable	342,982	562,920
Deferred income taxes	717,754	715,611
Total current assets	<u>17,942,772</u>	<u>36,712,071</u>
Property, plant, and equipment	491,369,529	469,924,566
Less accumulated depreciation	339,069,336	327,062,167
Property, plant, and equipment, net	<u>152,300,193</u>	<u>142,862,399</u>
Other assets:		
Investment securities	4,682,738	4,772,217
Investments in unconsolidated entities	9,456,894	8,389,380
Intangibles, net of amortization	15,459,367	16,755,833
Goodwill	27,232,656	27,232,656
Other noncurrent assets	1,120,872	1,331,863
Total other assets	<u>57,952,527</u>	<u>58,481,949</u>
Total assets	<u>\$ 228,195,492</u>	<u>\$ 238,056,419</u>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Current maturities of bank note	\$ 5,500,000	\$ 5,500,000
Current maturities of capital lease obligations	139,276	-
Accounts payable and payroll withholdings	2,123,128	2,404,797
Advance billings and customer deposits	3,528,138	3,763,357
Income taxes payable	-	873,475
Accrued expenses	5,910,582	12,607,898
Accrued taxes	838,878	945,193
Total current liabilities	<u>18,040,002</u>	<u>26,094,720</u>
Other liabilities:		
Bank note, net of current maturities	38,500,000	44,000,000
Capital lease obligations, net of current maturities	6,024,352	-
Deferred income taxes	25,807,972	31,826,228
Accrued pension benefits	32,324,802	13,082,088
Accrued postretirement benefits	829,955	604,047
Other liabilities and deferred credits	654,424	707,516
Total other liabilities	<u>104,141,505</u>	<u>90,219,879</u>
Total liabilities	<u>122,181,507</u>	<u>116,314,599</u>
Stockholders' equity:		
Preferred stock	1,911,600	1,946,300
Common stock	11,371,395	11,415,775
Paid in capital	55,448	47,324
Retained earnings	117,870,767	121,726,634
Accumulated other comprehensive loss	(25,195,225)	(13,394,213)
Total stockholders' equity	<u>106,013,985</u>	<u>121,741,820</u>
Total liabilities and stockholders' equity	<u>\$ 228,195,492</u>	<u>\$ 238,056,419</u>

## Consolidated Statements of Net Income—Unaudited

Six Months Ended June 30,	2015	2014
Operating revenues:		
Residential broadband	\$ 12,213,819	\$ 12,107,103
Business wireline	12,704,410	12,234,522
Data center	7,077,714	6,337,587
Total strategic	31,995,943	30,679,212
Residential legacy telecom	6,307,779	7,056,423
Wholesale	6,619,225	6,731,676
Advertising and search	1,400,496	1,401,424
Total operating revenues	46,323,443	45,868,735
Less uncollectible revenue	474,034	1,087,575
Net operating revenues	45,849,409	44,781,160
Cost of sales and service:		
General support	3,146,221	2,830,769
Central office	4,358,131	4,241,348
Communication termination	5,816,105	5,097,345
Cable and wire facilities	1,725,507	2,098,172
Network operations	4,047,170	3,736,310
Total cost of sales and service	19,093,134	18,003,944
Gross margin	26,756,275	26,777,216
Depreciation and amortization expense	9,419,297	9,531,990
Selling, general, and administrative expense:		
Customer operations	9,093,138	7,498,607
Corporate operations	4,508,105	3,265,423
Taxes, other than income taxes	689,189	686,136
Total selling, general, and administrative expense	14,290,432	11,450,166
Net operating income	3,046,546	5,795,060
Nonoperating income (expense):		
Interest income	59,909	75,505
Interest expense, net of capitalized interest	(480,621)	(507,209)
Equity in earnings of unconsolidated entities	4,284,945	3,960,327
Net gain (loss) on sale of investment securities	9,545	(1,083)
Other income, net	89,656	59,931
Net nonoperating income	3,963,434	3,587,471
Income before income taxes	7,009,980	9,382,531
Income taxes	2,604,854	3,623,431
Net income	4,405,126	5,759,100
Preferred stock dividends	45,317	46,185
Net income available to common stockholders	\$ 4,359,809	\$ 5,712,915
Earnings per average common share	\$1.91	\$2.50
Dividends per common share	\$2.60	\$2.60
Weighted average common shares outstanding	2,277,559	2,283,691

## Consolidated Statements of Comprehensive Income—Unaudited

<b>Six Months Ended June 30,</b>	<b>2015</b>	<b>2014</b>
Net income	\$ 4,405,126	\$ 5,759,100
Other comprehensive income, net of tax:		
Unrealized holding gains arising during the period, net of tax expense in 2015 of \$8,860 and tax expense in 2014 of \$63,483	14,130	99,738
Other comprehensive income, net of tax	14,130	99,738
Comprehensive income	\$ 4,419,256	\$ 5,858,838

## 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, 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
Balance, January 1, 2015	\$ 1,915,200	\$ 11,395,825	\$ 53,936	\$ 119,745,974	\$ (25,616,655)	\$ 407,300	\$ (25,209,355)	\$ 107,901,580
Acquisition of stock	(3,600)	(24,430)	1,512					(26,518)
Net income				4,405,126				4,405,126
Preferred stock dividends				(45,317)				(45,317)
Common stock dividends				(5,922,839)				(5,922,839)
Acquisition of common stock in excess of stated value				(312,177)				(312,177)
Unrealized gain on marketable securities, net of tax expense						14,130	14,130	14,130
Balance, June 30, 2015	\$ 1,911,600	\$ 11,371,395	\$ 55,448	\$ 117,870,767	\$ (25,616,655)	\$ 421,430	\$ (25,195,225)	\$ 106,013,985



## Consolidated Statements of Cash Flows—Unaudited

Six Months Ended June 30,	2015	2014
<b>Cash flows from operating activities:</b>		
Net income	\$ 4,405,126	\$ 5,759,100
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	9,419,297	9,531,990
Loss (gain) on sale of investment securities	(9,545)	1,083
Loss (gain) on sale, disposal, and abandonment of other assets	115,944	162,747
Equity in earnings of unconsolidated entities	(4,284,945)	(3,960,327)
Deferred income taxes	(927,297)	113,463
Deferred pension and postretirement benefits	761,935	(221,700)
Changes in operating assets and liabilities:		
Accounts receivable	(112,763)	799,191
Materials and supplies	(493,024)	54,838
Other assets	4,422,986	981,753
Accounts payable and payroll withholdings	(4,263,502)	(1,236,550)
Accrued expenses	(450,041)	5,089,945
Other liabilities	(590,712)	(4,646,009)
Net cash provided by operating activities	<u>7,993,459</u>	<u>12,429,524</u>
<b>Cash flow from investing activities:</b>		
Additions to property, plant, and equipment	(13,005,552)	(7,035,120)
Cost of removal of telephone plant, net of salvage	(51,584)	(43,760)
Proceeds from sale of wireless assets-escrow, net	2,350,000	-
Proceeds from sale of investment securities	3,685,000	8,110,000
Purchases of investment securities	-	(4,676,574)
Distributions from equity investments	23,834	-
Distributions from unconsolidated entities	3,195,775	4,415,980
Net cash provided by (used in) investing activities	<u>(3,802,527)</u>	<u>770,526</u>
<b>Cash flows from financing activities:</b>		
Principal payments on term loan	(2,750,000)	(2,750,000)
Principal payments on capital leases	(49,889)	-
Loan origination fees	(1,606)	-
Acquisition of preferred stock	(2,088)	-
Acquisition of common stock	(336,607)	(103,639)
Cash dividends paid	(5,968,156)	(5,984,475)
Net cash used in financing activities	<u>(9,108,346)</u>	<u>(8,838,114)</u>
Net change in cash and cash equivalents	(4,917,414)	4,361,936
Cash and cash equivalents at beginning of period	9,869,059	7,568,644
Cash and cash equivalents at end of period	<u>\$ 4,951,645</u>	<u>\$ 11,930,580</u>
Short term investment securities at end of period	<u>\$ -</u>	<u>\$ 9,847,450</u>
Total cash, cash equivalents, and short term investment securities	<u>\$ 4,951,645</u>	<u>\$ 21,778,030</u>
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid for (refunds of ) income taxes	<u>\$ 880,000</u>	<u>\$ 2,147,966</u>
Cash paid for interest	<u>\$ 448,831</u>	<u>\$ 494,216</u>
<b>Supplemental schedule of noncash investing and financing activities:</b>		
Property, plant, and equipment funded by capital lease obligations	<u>\$ 6,213,517</u>	<u>\$ -</u>

Jonathan M. Cage, hereby certify that the accompanying unaudited consolidated balance sheets of North State Telecommunications Corporation and Subsidiaries as of June 30, 2015 and 2014 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 23rd day of July 2015.



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  
Chief Administrative Officer

**Royster Tucker III**  
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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