

# THE SHAREHOLDER FORUM

C/O LUTIN & COMPANY  
575 MADISON AVENUE – 10<sup>TH</sup> FLOOR, NEW YORK, NEW YORK 10022  
TELEPHONE: (212) 605-0335

April 4, 2011

By email

Mr. C. Hayden McKenzie  
Chairman, Board of Directors  
North State Telecommunications Corporation  
111 North Main Street  
High Point, North Carolina 27260

Dear Mr. McKenzie:

For your consideration in addressing shareholder interests at the annual meeting later this week, investor reactions to North State's recently distributed 2010 Operations & Financial Summary seemed to focus on these issues:

- ▶ **Sustainability of dividend** – Some shareholders were concerned that 2010 was the second year in a row in which the company did not generate enough net income to cover its dividends. Counting just the “regular” \$1.30 quarterly dividends, without last year’s “special one-time dividend,” only 60% of that long-standing \$5.20 annual distribution came from the company’s \$3.08 earnings per share. (Even the theoretical \$4.63 “Normalized Earnings Per Share” reported in your Summary, calculated to eliminate results of investments and discontinued projects addressed below, would cover less than 90% of dividends.) This raises the question of how the company will continue dividend payments at recent levels without further draining of the company’s previously accumulated capital.
  
- ▶ **Risks of technology investments** – The report of a “one-time charge of \$11 million due to the write-down of an unsuccessful IT project” was viewed by some shareholders as the kind of investment loss that has to be expected from time to time in a technology company. This experience makes it clear that the funding of these experimental projects is actually an essential element of North State’s planned transformation from a traditional utility to an innovative technology company. Shareholders therefore need to know how the company will manage these unpredictable costs without sacrificing either its capital expenditures for existing service maintenance or its regular dividends.

These issues are of course related, and should be considered in the context of the importance of dividends to a very high proportion of your shareholders who responded to the Forum’s recent survey.\*

---

\* The report of survey results that was sent to you a week ago, including its appended list of the questions shareholders had submitted for presentation to the company, is attached. It is also available on the Shareholder Forum’s website at [www.shareholderforum.com/nors/Program/20110328\\_report.htm](http://www.shareholderforum.com/nors/Program/20110328_report.htm).

Please let me know how your responses to these issues or any other shareholder questions, including those presented in the Forum's survey, will be made available to shareholders other than the holders of Class A shares who are allowed to attend this week's annual meeting.

Your commitment to improved investor reporting, as promised in your introduction of the new Operations & Financial Summary, should be widely appreciated by North State's shareholders. I will of course welcome any opportunity for the Forum to support your efforts to provide all of your shareholders with fair, timely access to the information they need for their investment decisions.

Sincerely,

THE SHAREHOLDER FORUM

A handwritten signature in blue ink, appearing to read "Gary Lutin", with a horizontal line extending to the right.

Gary Lutin, Chairman

## Survey of North State Telecommunications Shareholders Ranking the Importance of Investor Interests

[Ranking the Importance of Investor Interests](#)  
[Time Periods Considered in Evaluating Interests](#)  
[Need for Additional Reporting to Shareholders](#)  
[Shareholder Questions for Management](#)  
[Concluding Observations](#)

[Exhibit: Shareholder Questions Presented for Management](#)

The Shareholder Forum was asked to conduct an independent survey of North State Telecommunications shareholders to determine their views of the relative importance of investment interests such as dividend income, stock price, business risk, and financial reporting. All shareholders who had been registered owners of North State stock for at least one year were invited to participate in the survey.<sup>1</sup>

The responses of participating shareholders to questions about their period of stock ownership, number of shares owned and how shares were acquired indicated that their range of perspectives could be considered generally representative of North State's long-term investors.<sup>2</sup> Their views of what is important are summarized below, and the actual questions that shareholders asked the Forum to present to the company's management are presented in an appended exhibit.

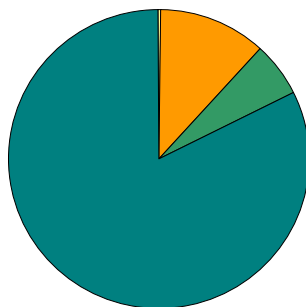
---

<sup>1</sup> A February 8, 2011 invitation letter from the Shareholder Forum was mailed to a list of shareholders reported to own either the Class A or Class B common stock of the company one year ago, in February 2010. For what was presented to shareholders, see

- [Letter inviting participation](#)
- [Survey](#) (for printable version of questionnaire, [click here](#))

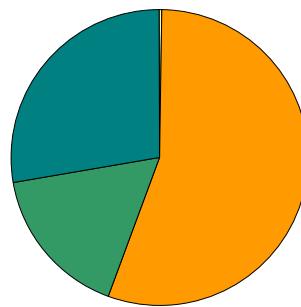
<sup>2</sup> More than 75% of participating shareholders answered optional questions about their perspectives, in the proportions shown in these charts:

**Period of Stock Ownership**



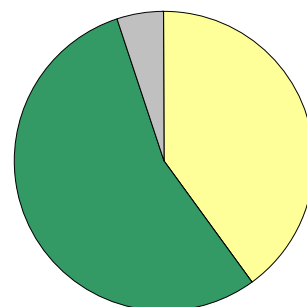
■ Less than 1 year  
■ From 1 to 3 years  
■ From 3 to 10 years  
■ More than 10 years

**Number of Shares Owned**



■ Fewer than 100 shares  
■ 100 to 1,000 shares  
■ 1,000 to 5,000 shares  
■ Over 5,000 shares

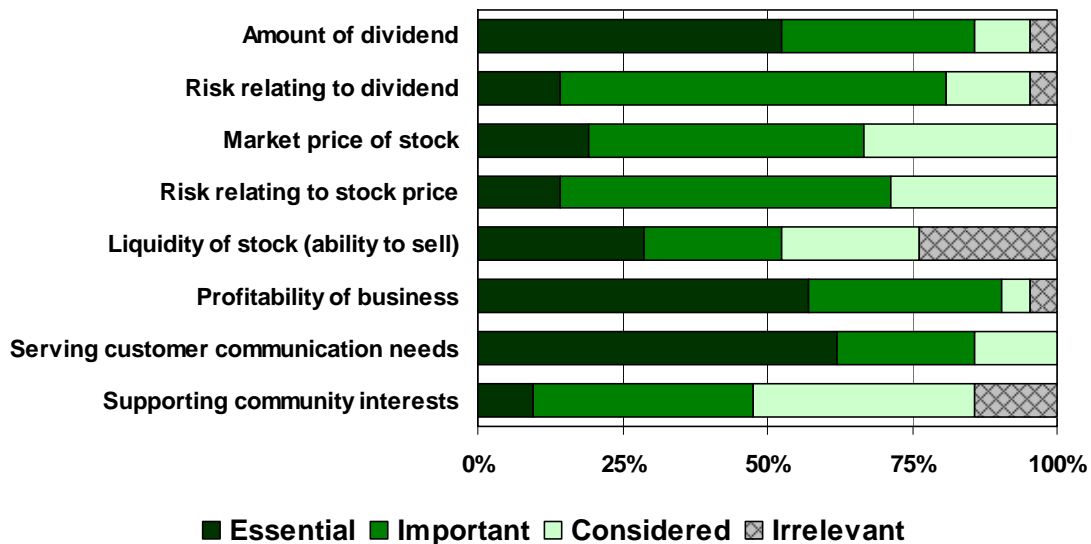
**How Shares Were Acquired**



■ Open market purchase  
■ Employee purchase rights  
■ Inheritance or gift  
■ Other

Note: Multiple responses were allowed for how shares were acquired.

## Ranking the Importance of Investor Interests



The chart above shows the proportions of participating shareholders who ranked each of the listed interests “essential,” “important,” “considered” or “irrelevant.”

Notably, even for a traditional telephone company, the participants ranked dividends significantly higher in importance than stock price, with more than half the participants viewing the amount of dividend essential, and about 80% of them viewing both the amount and risk relating to the dividend as either essential or important. This focus on dividends was more pronounced among larger shareholders, with more than 85% of the holders of over 1,000 shares viewing the amount of dividends essential and almost 90% of them viewing risk relating to dividends either an important or essential concern.

This unusually strong interest in dividends may be attributable to the relatively high proportion of responding shareholders whose investment interests are concentrated in North State. The following comment is representative of these perspectives:

*“Most of my income is NST dividends; therefore it is essential for my living (age [over 65]).” – from a participant who reported being a shareholder for over 10 years, with over 5,000 shares acquired by inheritance or gift (exact age deleted from comment to avoid identification of an anonymous participant)*

Other comments presented concerns about interests other than those listed in the survey question, such as these:

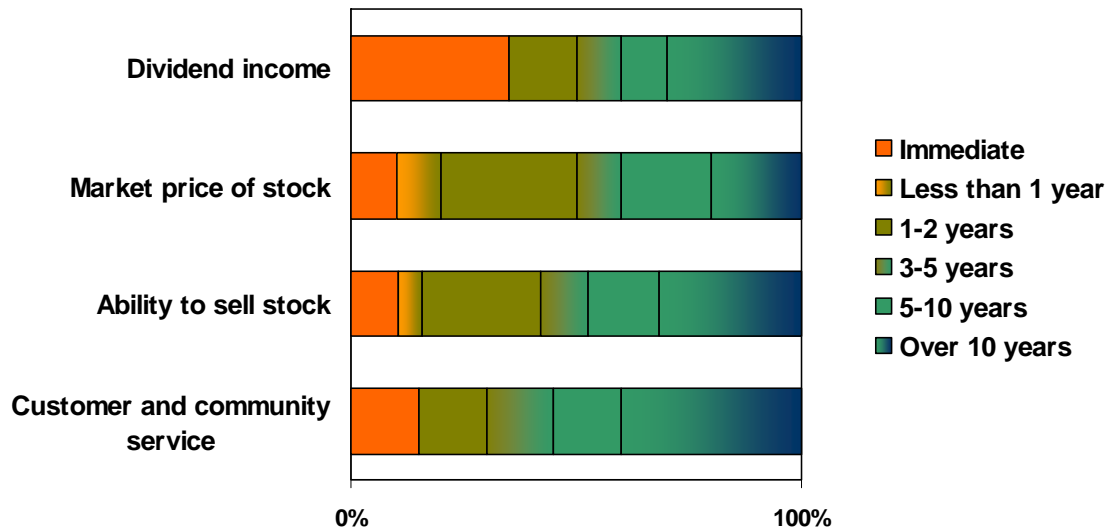
*“Ability to compete with current broadband suppliers.” – from a participant who reported being a shareholder for*

## THE SHAREHOLDER FORUM

*over 10 years, with between 1,000 and 5,000 shares acquired by inheritance or gift*

*“I like owning a local stock and appreciate their contribution to the community. I bought it for the dividend and hope for some appreciation. I trust management to decide what is best, to sell or to hang in there.” – from a participant who reported being a shareholder for 1 to 3 years, with between 100 and 1,000 shares acquired “from a family member through the company”*

### Time Periods Considered in Evaluating Interests



As would be expected of investors holding stock that is not actively traded, the chart of responses above shows that North State’s shareholders generally consider their interests in the context of relatively long periods of time. The exceptionally high proportion of “immediate” concern with dividend income is significant, though, especially in the context of the strong ranking of dividend importance in the previous question.

Responding in the space for commenting on interests other than those listed above, participants offered these views:

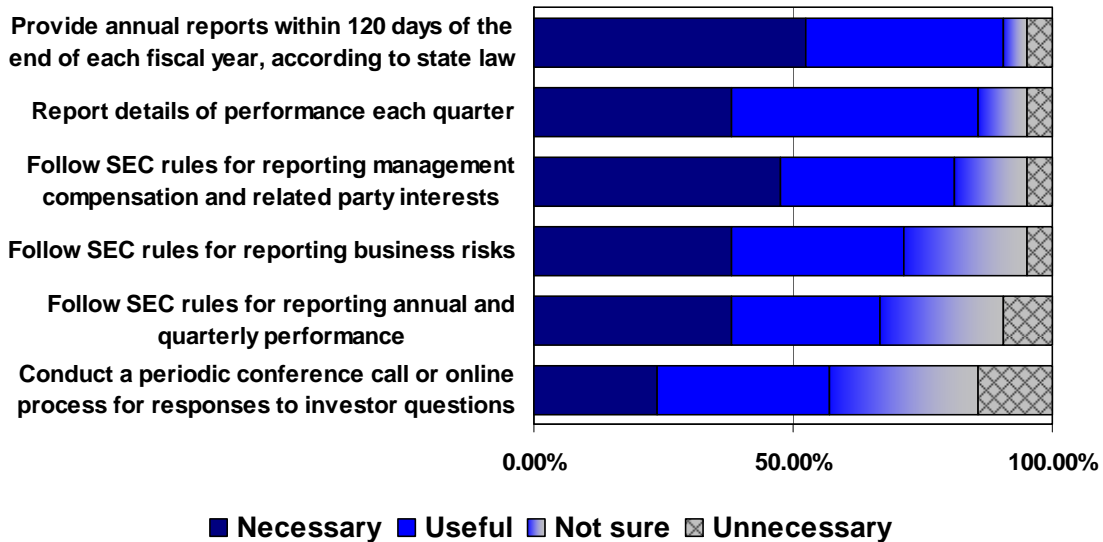
*“I am concerned that North State will not be able to keep up with technology to compete with other telcoms. Also, even if it does, I am concerned that whatever is gained will be enough to offset the loss of landline users. Further, I wonder if some of the decisions of management are based more upon sentimentality than practicality. Even though North State is a company with a long, distinctive past in the*

## THE SHAREHOLDER FORUM

community, management must consider the future and be objective when considering all the options available to the shareholders now.”<sup>3</sup> – *from a participant who reported being a shareholder for over 10 years, with between 100 and 1,000 shares acquired by inheritance or gift*

“ability to track stock value, and some form of independent evaluation of the company's future” – *from a participant who who reported being a shareholder for over 10 years, with between 100 and 1,000 shares acquired by inheritance or gift*

### Need for Additional Reporting to Shareholders



Understanding that some shareholders were concerned about the quality and timeliness of North State reporting – recently limited to mailing an annual report almost a year after the end of the period<sup>4</sup> and only brief summaries of interim performance in dividend cover letters – the survey included a question about whether various alternatives would be considered useful.<sup>5</sup> A majority of participating shareholders, as shown in the

<sup>3</sup> The participant continued this comment on the subject of the survey itself, as follows: “Regarding this survey, since it is conducted under anonymity, you will be able to report how many shareholders respond but you won’t be able to report the number of shares that are represented. So, while I think your findings will be interesting, I don’t think they will be conclusive.”

<sup>4</sup> The company’s annual report for the year ended December 31, 2009 was sent to shareholders in December 2010, with an audit opinion dated October 14, 2010. See the [2009 Annual Report of North State Telecommunications Corporation \[distributed December 2010\]](#) (40 pages, 2,294 KB, in [PDF format](#)).

<sup>5</sup> This question also presented the following parenthetical statement: “Note that North State is not currently required to follow SEC reporting rules, and that references to SEC rules are intended only as an indication

## THE SHAREHOLDER FORUM

chart above, considered each of the listed reporting improvements to be either “necessary” or “useful.” Significantly, about half the shareholders gave a “necessary” ranking to compliance with the 120 day state law requirement for annual reports and also to full disclosures of management compensation and related party interests.

It should be noted, however, that the responses also included representation of a view that there is no need to change existing reporting practices. One survey participant, for example, ranked every listed reporting alternative as “unnecessary” and offered the following comment:

*“I find the quarterly reports that accompany dividend checks to be more informative and useful than anything I get from other investments.” – from a participant who reported being a shareholder for over 10 years, with between 100 and 1,000 shares bought in the open market, ranking the amount of dividends and price of stock equally as only “considered” and commenting that the “essential” investment interest was as follows: “The company has plans in place for future growth, and those plans are already showing results. Instead of selling now to a bunch of vultures who just want to take cash and run, I would rather watch my stock double in value as growth plans play out.”<sup>6</sup>*

### Shareholder Questions for Management

Shareholders participating in the survey were invited to present questions for the Forum’s submission to North State’s management, identifying sources only as anonymous participants in the survey to encourage candid inquiries. Nine questions were presented, and the Forum submitted them to the company’s chief executive and chairman of the board on March 14, 2011. Other than to acknowledge receipt, the company has declined to respond to the shareholder questions.

Copies of the submitted questions are presented in the appended exhibit, exactly as participating shareholders submitted them except for noted deletions of information that might identify the anonymous source.

### Concluding Observations

The views reported by shareholders participating in this survey showed a relatively strong focus on dividends as well as normal levels of interest in stock price. As

---

of practices followed by other companies. For applicable state law reporting requirements, see [North Carolina General Statutes §55-16-20, Financial statements for shareholders.](#)”

<sup>6</sup> This participant also presented the following question for submission to the company’s management: “Dear Management, I believe you have an excellent plan in place to grow the company. I honestly believe the company can easily double in size in the next 10 years. Keep up the good work. A shareholder”

## THE SHAREHOLDER FORUM

would be expected of shareholders with long-term perspectives, and especially with a high proportion of inherited holdings, survey participants also expressed a strong interest in being provided with information that would allow them to understand the company's progress and prospects, and also to monitor its executive management.

Shareholders should have opportunities during the next few weeks to seek the information they need. Although North State's management declined to respond to the questions presented by participants in this survey, the company's chief executive officer and chairman did respond to the survey with his own letter to shareholders stating that the company will welcome questions and comments submitted directly to them.<sup>7</sup> The company's management has also promised to immediately send holders of the Class A voting stock copies of "unaudited summary financial statements" for the 2009 and 2010 fiscal years and to review the company's "financial results and operations" with that class of shareholders at the annual meeting on April 6, 2011.<sup>8</sup> It is assumed that management will provide the same information access rights to the holders of Class B stock.

This report of survey results will of course be provided to the company's management. North State shareholders are encouraged to offer their further questions and comments to the Forum, or to the company's management. In any event, all of the shareholders who participated in the survey are thanked for their time and efforts to help define the investor interests that should be addressed.

*GL – March 28, 2011*

Gary Lutin  
Chairman, The Shareholder Forum  
c/o Lutin & Company  
575 Madison Avenue, 10th Floor  
New York, New York 10022  
Tel: 212-605-0335  
Email: [gl@shareholderforum.com](mailto:gl@shareholderforum.com)

---

<sup>7</sup> See [February 16, 2011, C. Hayden McKenzie, Chairman and Chief Executive Officer of North State Telecommunications, letter to shareholders concerning survey of investor interests](#) (1 page, 357 KB, in [PDF format](#)).

<sup>8</sup> The notice for the annual meeting states that this year "Attendance at the Meeting is limited to holders of Shares of Class A Voting Common Stock." See [March 9, 2011 Notice of Meeting to Holders of Class A Voting Common Stock, for Annual Meeting of Stockholders of North State Telecommunications Corporation on April 6, 2011](#) (2 pages, 574 KB, in [PDF format](#)).



**February 2011 Survey of North State Telecommunications Shareholders**  
**Shareholder Questions Presented for Management**

**Question #4:** *“If you would like to have the Shareholder Forum present a question to North State’s management (reporting the source only as an unidentified participant in this survey), please tell us here what you want us to ask:”*

**9 comments offered in response to open question**

**\*\* \*\* \***

- 
- 1 Look at what the company would be worth on the open market and how this would impact stock price.
- 
- 2 What is the open market value of the stock?  
How does North State plan to compete with low-cost telecommunication companies in this market?
- 
- 3 Dear Management,  
I believe you have an excellent plan in place to grow the company. I honestly believe the company can easily double in size in the next 10 years. Keep up the good work.  
A shareholder
- 
- 4 I would like for the North State Website to have an investors link where we could send questions and also make a forum where we could see other investor concerns.
- 
- 5 Is North State still committed to serving it's customers in and honest, straightforward manner? It seems that the principals that got NSC where it is today are being abandoned. Is there any opinion among management that NSC can still be considered a solid, local company that cares about the people it serves or is NSC going to become just corporate entity who cares only about the bottom line?
- 
- 6 I'm interested in when underground Cable/internet/phone (PLEX) service will be available in the *[street name deleted]* area.
- 
- 7 I would like to know why they spent eleven million dollars on a new billing system and never used the system? Eleven million dollars wasted!  
How is responsible for making that decision and are they still with the company? If so WHY?
-

**February 2011 Survey of North State Telecommunications Shareholders**  
**Shareholder Questions Presented for Management**

**Question #4:** *“If you would like to have the Shareholder Forum present a question to North State's management (reporting the source only as an unidentified participant in this survey), please tell us here what you want us to ask:”*

**9 comments offered in response to open question**

\*\* \*\* \*

---

8 Are we really able to provide value that our customers would not be able to get elsewhere? 50 years ago -- absolutely. Today? I worry that we are not providing much additional value over lots of competitors, but we have not adjusted our mindset.

TV, Voice, Internet -- are all just data -- and you can get that data from so many companies, including wireless, cable, etc. I have read that there are ways to transmit data over power lines as well -- maybe the utilities will start competing too. I worry we are spending so much money to try to grow the business even though the economics have changed for the worse in so many ways and now we must compete, at great expense to our shareholders, with really big companies.

Our stock (NORSA) first traded for \$80 in late 1995. That was before the big bubble of the late 90s, when we got to \$150. 15 years later -- almost enough time to send a baby to college -- our stock is still trading for \$80. When you count inflation, that's probably more like \$50 in 1995 dollars. I don't want to sound like I am only negative: the Board has always paid a good dividend, and unlike a lot of folks we have not gone out of business.

But 15 years is a very long time to have no capital gain. If the investments (and there have been a lot of them!) we made over the last 15 years had been really profitable, then we would have a much higher stock today. But like I said, the economics of the business seem to have changed for the worse, and I worry that we have not recognized that change.

I guess we can try to fight the big fight, take on the cable companies, etc., but even if we're still standing in 15 years, I worry that the competition will mean our profits will be lower in 2025 than they are today.

How does that help anyone, in the end?

Maybe I am too pessimistic, although I have been patient and supportive of our company for many years. Even if that is true, though, I think the most important things for the Board to communicate with shareholders are:

- (a) What kinds of benchmarks they are setting for the future
  - (b) How progress towards these benchmarks will be measured
  - (c) What the plans are if the benchmarks are not met
  - (d) Under what conditions would the board decide to throw in the towel and try to find a buyer the way that Lexcom (which I also owned for many years) did.
-

**February 2011 Survey of North State Telecommunications Shareholders**  
**Shareholder Questions Presented for Management**

**Question #4:** *“If you would like to have the Shareholder Forum present a question to North State's management (reporting the source only as an unidentified participant in this survey), please tell us here what you want us to ask:”*

**9 comments offered in response to open question**

**\*\* \*\* \***

---

9      Why can't we have more transparency - why can't we have the daily stock value easily available and information on insider trading?

---