PEOPLES BANCORP OF NORTH CAROLINA INC
Form DEF 14A
March 29, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

(Rule 14a-101)

Proxy Statement Pursuant to Section 14(a)
of the Securities Exchange Act of 1934

Filed by the Registrant	[X]
Filed by a Party other than the Registrant	[ ]

Check the appropriate box:

[ ]	Preliminary Proxy Statement	[ ] Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
[X]	Definitive Proxy Statement	
[ ]	Definitive Additional Materials	
[ ]	Soliciting Material Pursuant to §240.14a-12	

Peoples Bancorp of North Carolina, Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

[X]		No fee required.
[ ]		Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
	(1)	Title of each class of securities to which transaction applies:
	(2)	Aggregate number of securities to which transaction applies:
	(3)	Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

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PEOPLES BANCORP
OF NORTH CAROLINA, INC.

Notice of 2010 Annual Meeting,
Proxy Statement and
Annual Report

PEOPLES BANCORP OF NORTH CAROLINA, INC.

PROXY STATEMENT

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PEOPLES BANCORP OF NORTH CAROLINA, INC.
Post Office Box 467
518 West C Street
Newton, North Carolina 28658-0467
(828) 464-5620

NOTICE OF 2010 ANNUAL MEETING OF SHAREHOLDERS
To Be Held on May 6, 2010

NOTICE IS HEREBY GIVEN that the 2010 Annual Meeting of Shareholders of Peoples Bancorp of North Carolina, Inc. (the "Company") will be held as follows:

Place: Catawba Country Club
1154 Country Club Road
Newton, North Carolina

Date: May 6, 2010

Time: 11:00 a.m., Eastern Time

The purposes of the Annual Meeting are to consider and vote upon the following matters:

- To elect four persons who will serve as members of the Board of Directors until the 2011 Annual Meeting of Shareholders or until their successors are duly elected and qualified;

- To participate in an advisory (non-binding) vote to approve the compensation of the Company's executive officers, as disclosed in the Proxy Statement;

- To ratify the appointment of Porter Keadle Moore, LLP ("PKM") as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2010; and

- To consider and act on any other matters that may properly come before the Annual Meeting or any adjournment.

The Board of Directors has established March 17, 2010, as the record date for the determination of shareholders entitled to notice of and to vote at the Annual Meeting. If an insufficient number of shares is present in person or by proxy to constitute a quorum at the time of the Annual Meeting, the Annual Meeting may be adjourned in order to permit further solicitation of proxies by the Company.

Your vote is important. We urge you to vote as soon as possible so that your shares may be voted in accordance with your wishes. You may vote by executing and returning your proxy card in the accompanying envelope, or by voting electronically over the Internet or by telephone. Please refer to the proxy card enclosed for information on voting electronically. If you attend the meeting, you may vote in person and the proxy will not be used.

By Order of the Board of Directors,

/s/ Tony W. Wolfe
Tony W. Wolfe
President and Chief Executive Officer

Newton, North Carolina
March 29, 2010

PEOPLES BANCORP OF NORTH CAROLINA, INC.

PROXY STATEMENT

Annual Meeting of Shareholders
To Be Held On May 6, 2010

This Proxy Statement is being mailed to our shareholders on or about March 29, 2010, for solicitation of proxies by the Board of Directors of Peoples Bancorp of North Carolina, Inc. Our principal executive offices are located at 518 West C Street, Newton, North Carolina 28658. Our telephone number is (828) 464-5620.

In this Proxy Statement, the terms "we," "us," "our" and the "Company" refer to Peoples Bancorp of North Carolina, Inc. The term "Bank" means Peoples Bank, our wholly-owned, North Carolina-chartered bank subsidiary. The terms "you" and "your" refer to the shareholders of the Company.

Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting to Be Held on May 6, 2010. The Notice, Proxy Statement and the Annual Report to Shareholders for the year ended December 31, 2009 are also available at
https://www.snl.com/IRWebLinkX/GenPage.aspx?IID=4050385&GKP=202713
You may also access the above off-site website by going to www.peoplesbanknc.com and click on the link.

INFORMATION ABOUT THE ANNUAL MEETING

Your vote is very important. For this reason, our Board is requesting that you allow your common stock to be represented at the 2010 Annual Meeting of Shareholders by the proxies named on the enclosed proxy card.

When is the Annual Meeting?	May 6, 2010, at 11 a.m., Eastern Time.	
Where will the Annual Meeting be held?	At the Catawba Country Club, 1154 Country Club Road, Newton, North Carolina.	
What items will be voted on at the Annual Meeting?	1.	ELECTION OF DIRECTORS. To elect four directors to serve until the 2011 Annual Meeting of Shareholders;
	2.	PARTICIPATION IN ADVISORY VOTE. To participate in an advisory (non-binding) vote to approve the compensation of the Company's executive officers, as disclosed in the Proxy Statement;
	3.	

RATIFICATION OF REGISTERED PUBLIC ACCOUNTING FIRM. To ratify the appointment of PKM as the Company's independent registered public accounting firm for fiscal year 2010; and

4. OTHER BUSINESS. To consider any other business as may properly come before the Annual Meeting or any adjournment.

1

Who can vote?	Only holders of record of our common stock at the close of business on March 17, 2010 (the "Record Date") will be entitled to notice of and to vote at the Annual Meeting and any adjournment of the Annual Meeting. On the Record Date, there were 5,539,056 shares of our common stock outstanding and entitled to vote and 712 shareholders of record.
How do I vote by proxy?	You may vote your shares by marking, signing and dated the enclosed proxy card and returning it in the enclosed postage-paid envelope or by voting electronically over the Internet or by telephone using the information on the proxy card. If you return your signed proxy card before the Annual Meeting, the proxies will vote your shares as you direct. The Board of Directors has appointed proxies to represent shareholders who cannot attend the Annual Meeting in person. For the election of directors, you may vote for (1) all of the nominees, (2) none of the nominees, or (3) all of the nominees except those you designate. If a nominee for election as a director becomes unavailable for election at any time at or before the Annual Meeting, the proxies will vote your shares for a substitute nominee. For each other item of business, you may vote "FOR" or "AGAINST" or you may "ABSTAIN" from voting. If you return your signed proxy card but do not specify how you want to vote your shares, the proxies will vote them "FOR" the election of all of our nominees for directors and "FOR" all other proposals presented in this Proxy Statement in accordance with Board of Directors recommendations. If your shares are held in the name of a broker or other nominee (i.e., held in "street name"), you will need to obtain a proxy instruction form from the broker holding your shares and return the form as directed by your broker. Effective January 1, 2010, your broker is no longer permitted to vote on your behalf on the election of directors unless you provide specific instructions by following the instructions from your broker about voting your shares by telephone or Internet or completing and returning the voting instruction card provided by your broker. For

your vote to be counted in the election of directors, you now will need to communicate your voting decision to your bank, broker or othe holder of record before the date of the Annual Meeting.

We are not aware of any other matters to be brought before the Annual Meeting. If matters other than those discussed above are properly brought before the Annual Meeting, the proxies may vote your shares in accordance with their best judgment.

How do I change or revoke my proxy?	You can change or revoke your proxy at any time before it is voted at the Annual Meeting in any of three ways: (2) by delivering a written notice of revocation to the Secretary of the Company; (2) by delivering another properly signed proxy card to the Secretary of the Company with a more recent date than your first proxy card or by changing your vote by

telephone or the Internet; or (3) by attending the Annual Meeting and voting in person. You should deliver your written notice or superseding proxy to the Secretary of the Company at our principal executive offices listed above.

How many votes can I cast?

You are entitled to one vote for each share held as of the Record Date on each nominee for election and each other matter presented for a vote at the Annual Meeting. You may not vote your shares cumulatively in the election of directors.

How many votes are required to approve the proposals?

If a quorum is present at the Annual Meeting, each director nominee will be elected by a plurality of the votes cast in person or by proxy. If you withhold your vote on a nominee, your shares will not be counted as having voted for that nominee.

The proposal to approve the compensation of the Company's Named Executive Officers is advisory only; however, the Company's Compensation Committee will consider the outcome of the vote when evaluating compensation arrangements for executive compensation.

The proposal to ratify the appointment of the Company's independent registered public accounting firm for 2010 will be approved if the votes cast in favor exceed the votes cast in opposition.

Any other matters properly coming before the Annual Meeting for a vote will require the affirmative vote of the holders of a majority of the shares represented in person or by proxy at the Annual Meeting and entitled to vote on that matter.

Abstentions and broker non-votes are not treated as votes cast on any proposal. As a result, neither will have an effect on the vote for the election of any director or the ratification of our independent registered public accounting firm.

A broker non-vote occurs when a broker does not vote on a particular matter bacause the broker does not have discretionary authority on that matter and has not received instructions from the owner of the shares. Under new rules changes, brokers are no longer able to vote for directors without instructions from the record holder.

	In the event there are insufficient votes present at the Annual Meeting for a quorum or to approve or ratify any proposal, the Annual Meeting may be adjourned in order to permit the further solicitation of proxies.
What constitutes a "quorum" for the Annual Meeting?	A majority of the outstanding shares of our common stock entitled to vote at the Annual Meeting, present in person or represented by proxy, constitutes a quorum (a quorum is necessary to conduct business at the Annual Meeting). Your shares will be considered part of the quorum if you have voted

by proxy or by telephone or Internet. Abstentions, broker non-votes and votes withheld from any director nominee count as shares present at the Annual Meeting for purposes of determining a quorum.

Who pays for the solicitation of proxies?	We will pay the cost of preparing, printing and mailing materials in connection with this solicitation of proxies. In addition to solicitation by mail, our officers, directors and regular employees, as well as those of the Bank, may make solicitations personally, by telephone or otherwise without additional compensation for doing so. We reserve the right to engage a proxy solicitation firm to assist in the solicitation of proxies for the Annual Meeting. We will, upon request, reimburse brokerage firms, banks and others for their reasonable out-of-pocket expenses in forwarding proxy materials to beneficial owners of stock or otherwise in connection with this solicitation of proxies.
When are proposals for the 2011 Annual Meeting due?	To be considered either for inclusion in the proxy materials solicited by the Board of Directors for the 2011 Annual Meeting, proposals must be received by the Secretary of the Company at our principal executive offices at 518 West C Street, Newton, North Carolina 28658 (or at P.O. Box 467, Newton, North Carolina 28658-0467) no later than December 31, 2010. To be included in the proxy materials, a proposal must comply with our Bylaws, Rule 14a-8 and all other applicable provisions of Regulation 14A under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Any proposal not intended to be included in the Company's proxy statement for the 2011 Annual Meeting, but intended to be presented at that Annual Meeting, must be received by us at our principal executive offices listed above no later than February 16, 2011.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The Exchange Act, requires that any person who acquires the beneficial ownership of more than five percent of the Company's common stock notify the Securities and Exchange Commission (the "SEC") and the Company. Following is certain information, as of March 17, 2010, regarding those persons or groups who held of record, or who are known to the Company to own beneficially, more than five percent of the outstanding common stock.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership1	Percent of Class
Christine S. Abernethy P.O. Box 386 Newton, NC 28658	654,095 2	11.81% 3
U.S. Department of the Treasury 1500 Pennsylvania Avenue, NW Washington, D.C. 20220	357,234 4	6.06% 5

1 Unless otherwise noted, all shares are owned directly of record by the named individuals, by their spouses and minor children, or by other entities controlled by the named individuals. Voting and investment power is not shared unless otherwise indicated.

2 Carolina Glove Company, Inc. owns 107,604 shares of common stock. These shares are included in the calculation of Ms. Abernethy's total beneficial ownership interest. Ms. Abernethy owns approximately 50% of the stock of Carolina Glove Company, Inc. The business is operated by a family committee. Ms. Abernethy has no active day-to-day participation in the business affairs of Carolina Glove Company, Inc.

3 Based upon a total of 5,539,056 shares of common stock outstanding as of the Record Date.

4 The amount represents a warrant to purchase 357,234 shares of its common stock to the U.S. Department of the Treasury on December 28, 2008. As of March 17, 2010, the U.S. Department of the Treasury had not exercised the warrant. A description of the Company's participation in the Troubled Asset Relief Program and Capital Purchase Program can be found on page 14.

5 Based upon a total of 5,896,290 shares of common stock which is the sum of 5,539,056, the total number of shares outstanding as of the record date and 357,234 shares underlying the warrant which is currently exercisable.

5

Set forth below is certain information, as of the Record Date, regarding those shares of common stock owned beneficially by each of the persons who currently serves as a member of the Board of Directors, is a nominee for election to the Board at the Annual Meeting, or is a named executive officer ("NEO") of the Company. Also shown is the number of shares of common stock owned by the directors and executive officers of the Company as a group.

Name and Address	Amount and Nature of Beneficial Ownership1	Percentage of Class2
James S. Abernethy Post Office Box 327 Newton, NC 28658	171,414 3	3.03%
Robert C. Abernethy Post Office Box 366 Newton, NC 28658	170,749 4	3.02%
Joseph F. Beaman, Jr. Post Office Box 467 Newton, NC 28658	34,008 5	*
William D. Cable, Sr. Post Office Box 467 Newton, NC 28658	33,243 6	*
Douglas S. Howard Post Office Box 587 Denver, NC 28037	12,819 7	*
A. Joseph Lampron Post Office Box 467 Newton, NC 28658	21,638 8	*
John W. Lineberger, Jr. Post Office Box 481 Lincolnton, NC 28092	2,299	*
Gary E. Matthews 210 First Avenue South Conover, NC 28613	21,387	*
Billy L. Price, Jr., M.D. 540 11th Ave. Place NW Hickory, NC 28601	3,525	*
Larry E. Robinson Post Office Box 723 Newton, NC 28658	47,523 9	*

Lance A. Sellers Post Office Box 467 Newton, NC 28658	27,446 10	*	
William Gregory Terry Post Office Box 395 Conover, NC 28613	11,566	*	
Dan Ray Timmerman, Sr. Post Office Box 1148 Conover, NC 28613	60,426 11		1.07%
Tony W. Wolfe Post Office Box 467 Newton, NC 28658	28,978 12	*	

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Name and Address	Amount and Nature of Beneficial Ownership1	Percentage of Class2
Benjamin I. Zachary Post Office Box 277 Taylorsville, NC 28681	80,844 13	1.43%
All current directors and nominees and executive officers as a group (15 people)	663,827 14, 15	11.74%

*Does not exceed one percent of the common stock outstanding.

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1 Unless otherwise noted, all shares are owned directly of record by the named individuals, by their spouses and minor children, or by other entities controlled by the named individuals. Voting and investment power is not shared unless otherwise indicated.

2 Based upon a total of 5,539,056 shares of common stock outstanding as of the Record Date and 113,186 stock options exercisable within 60 days with respect to the designated recipient(s).

3 Includes 64,038 shares of common stock owned by Alexander Railroad Company. Mr. J. Abernethy is Vice President, Secretary and Chairman of the Board of Directors of Alexander Railroad Company.

4 Includes 5,530 shares of common stock owned by Mr. R. Abernethy's spouse, for which Mr. R. Abernethy disclaims beneficial ownership.

5 Includes 26,764 shares of common stock in which Mr. Beaman has the right to acquire beneficial interest within 60 days by the exercise of stock options granted under the Omnibus Stock Ownership and Long Term Incentive Plan.

6 Includes 20,444 shares of common stock in which Mr. Cable has the right to acquire beneficial interest within 60 days by the exercise of stock options granted under the Omnibus Stock Ownership and Long Term Incentive Plan.

7 Includes 2,475 shares of common stock owned by Mr. Howard's mother over which Mr. Howard holds a power of attorney. Includes 450 shares of common stock owned by Mr. Howard's spouse, for which Mr. Howard disclaims beneficial ownership.

8 Includes 18,400 shares of common stock in which Mr. Lampron has the right to acquire beneficial interest within 60 days by the exercise of stock options granted under the Omnibus Stock Ownership and Long Term Incentive Plan.

9 Includes 6,835 shares of common stock owned by Mr. Robinson's spouse, for which Mr. Robinson disclaims beneficial ownership.

10 Includes 21,455 shares of common stock in which Mr. Sellers has the right to acquire beneficial interest within 60 days by the exercise of stock options granted under the Omnibus Stock Ownership and Long Term Incentive Plan.

11

Includes 2,722 shares of common stock owned by Timmerman Manufacturing, Inc. Mr. Timmerman is President and a Director of Timmerman Manufacturing, Inc.

12 Includes 26,123 shares of common stock in which Mr. Wolfe has the right to acquire beneficial interest within 60 days by the exercise of stock options granted under the Omnibus Stock Ownership and Long Term Incentive Plan.

13 Includes 64,038 shares of common stock owned by Alexander Railroad Company. Mr. Zachary is President, Treasurer, General Manager and a Director of Alexander Railroad Company.

14 The 64,038 shares owned by Alexander Railroad Company and attributed to Mr. J. Abernethy and Mr. Zachary are only included once in calculating this total.

15 Includes 113,186 shares of common stock in which the executive officers, as a group, have the right to acquire beneficial interest within 60 days by the exercise of stock options granted under the Omnibus Stock Ownership and Long Term Incentive Plan.

Directors James S. Abernethy and Robert C. Abernethy are brothers and are sons of Christine S. Abernethy, who owns in excess of 10% of the common stock.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires the Company's executive officers and directors, and persons who own more than ten percent of the common stock, to file reports of ownership and changes in ownership with the SEC. Executive officers, directors and greater than ten percent beneficial owners are required by SEC regulations to furnish the Company with copies of all Section 16(a) forms they file.

Based solely on a review of the copies of such forms furnished to the Company and written representations from the Company's executive officers and directors, the Company believes that during the fiscal year ended December 31, 2009, its executive officers and directors and greater than ten percent beneficial owners complied with all applicable Section 16(a) filing requirements.

PROPOSAL 1

ELECTION OF DIRECTORS

Our Board of Directors has set its number at ten members. Our current Bylaws provide that in order to be eligible for consideration at the Annual Meeting of Shareholders, all nominations of directors, other than those made by the Nominating Committee or the Board of Directors, must be in writing and must be delivered to the Secretary of the Company not less than 50 days nor more than 90 days prior to the meeting at which such nominations will be made; provided, however, that if less than 60 days' notice of the meeting is given to the shareholders, such nominations must be delivered to the Secretary of the Company not later than the close of business on the tenth day following the day on which the notice of meeting was mailed.

Information about the nominees for election to the Board of Directors for a one-year term (until 2011) and directors continuing in office is given below.

Director Nominees

John W. Lineberger, Jr., age 59, is employed by Lincoln Bonded Warehouse Company, a commercial warehousing facility, as President. He has served as a director of the Company since 2004. Mr. Lineberger has a total of five years of banking experience and is a graduate of the North Carolina Bank Directors' College and attended the initial Advanced Directors' Training session offered by the NC Bank Directors' College in association with the College of Management at North Carolina State University. Mr. Lineberger earned a B.S. degree in business administration from Western Carolina University, Cullowhee, North Carolina.

Gary E. Matthews, age 54, is employed by Matthews Construction Company, Inc. as its President and a Director. He has served as a director of the Company since 2001. Mr. Matthews has a total of eight years of banking experience, is a graduate of the North Carolina Bank Directors' College, and attended the initial Advanced Directors' Training session offered by the NC Bank Directors' College in association with the College of Management at North Carolina State University. Mr. Matthews is also a director of Conover Metal Products, a privately held company. Mr. Matthews earned a B.S. degree in civil engineering/construction from North Carolina State University.

Dan Ray Timmerman, Sr., age 62, is employed by Timmerman Manufacturing, Inc., a wrought iron furniture, railings and gates manufacturer, as its President and Chief Executive Officer. He has served as a director of the Company since 1995. Mr. Timmerman has a total of 15 years of banking experience and is a graduate of the North Carolina Bank Directors' College and attended the initial Advanced Directors' Training session offered by the NC Bank

Directors' College in association with the College of Management at North Carolina State University. Mr. Timmerman earned a B.S. degree in business administration with a concentration in accounting from Lenoir-Rhyne University in North Carolina.

Benjamin I. Zachary, age 53, is employed by Alexander Railroad Company as its President, Treasurer, General Manager and Director. He has served as a director of the Company since 1995. Mr. Zachary has a total of 14 years of banking experience and is a graduate of the North Carolina Bank Directors' College. Mr. Zachary earned a B.S. degree in business administration with a concentration in accounting from the University of North Carolina at Chapel Hill. He worked as a CPA for a "Big 4" accounting firm for eight years following graduation where his assignments included financial statement audits of several banks. He is a member of the Finance Committee and has served as Treasurer of First United Methodist Church of Taylorsville for many years. Mr. Zachary is a member of the Taylorsville Rotary Club and also serves as Treasurer.

THE BOARD OF DIRECTORS RECOMMENDS THAT YOU VOTE "FOR" ALL OF THE NOMINEES NAMED ABOVE FOR ELECTION AS DIRECTORS.

Directors Continuing in Office

Robert C. Abernethy, age 59, is employed by Carolina Glove Company, Inc., a glove manufacturing company, as its President, Secretary and Treasurer. Mr. Abernethy continues to serve as Secretary and Assistant Treasurer of Midstate Contractors, Inc., a paving company. He has served as a director of the Company since 1976 and as Chairman since 1991. Mr. Abernethy has a total of 33 years of banking experience and is a graduate of the North Carolina Bank Directors' College and attended the initial Advanced Directors' Training session offered by the North Carolina Bank Directors' College in association with the College of Management at North Carolina State University. Mr. Abernethy earned a B.S. degree from Gardner Webb University in North Carolina. He serves on the Finance Committee and Investment Committee of Grace United Church of Christ. Mr. Abernethy also serves on the board of Carolina Glove Company, Inc. and Midstate Contractors, Inc. both privately held companies.

James S. Abernethy, age 55, is employed by Carolina Glove Company, Inc., a glove manufacturing company as its Vice President. Mr. Abernethy continues to serve as President and Assistant Secretary of Midstate Contractors, Inc., a paving company and also as Vice President, Secretary and Chairman of the Board of Directors of Alexander Railroad Company. He has served as a director of the Company since 1992. Mr. Abernethy has a total of 17 years of banking experience and is a graduate of the North Carolina Bank Directors' College and attended the initial Advanced Directors' Training session offered by the NC Bank Directors' College in association with the College of Management at North Carolina State University. Mr. Abernethy earned a business administration degree from Gardner Webb University in North Carolina. Over his 17 years of service on the Board, Mr. Abernethy has served on all the Bank's and the Company's committees.

Larry E. Robinson, age 64, is employed by The Blue Ridge Distributing Company, Inc., a beer and wine distributor, as the President and Chief Executive Officer. He is a partner and Chief Operating Officer of United Beverages of North Carolina, LLC, a beer distributor. He has served as a director of the Company since 1993. Mr. Robinson has a total of 16 years of banking experience and is a graduate of the North Carolina Bank Directors' College.

William Gregory Terry, age 42, is employed by Drum & Willis-Reynolds Funeral Homes and Crematory as Executive Vice President. He has served as a director of the Company since 2004. Mr. Terry has a total of five years of banking experience and is a graduate of the North Carolina Bank Directors' College and attended the initial Advanced Directors' Training session offered by the NC Bank Directors' College in association with the College of Management at North Carolina State University. Mr. Terry graduated with a B.S. degree in business management from Clemson University in South Carolina. Mr. Terry serves on numerous civic and community boards.

Douglas S. Howard, age 50, is employed by Howard Ventures, Inc. as Vice President. He is also employed by Denver Equipment of Charlotte, Inc. as Secretary/Treasurer. He has served as a director of the Company since 2004. Mr. Howard has a total of 11 years of banking experience and is a graduate of the North Carolina Bank Directors' College and attended the initial Advanced Directors' Training session offered by the NC Bank Directors' College in association with the College of Management at North Carolina State University. Mr. Howard also serves on the boards of privately-held companies.

Billy L. Price, Jr., M.D., age 53, is the Managing Partner and Practitioner of Internal Medicine at Catawba Valley Internal Medicine, PA. He has served as a director of the Company since 2004. Dr. Price has a total of five years of banking experience and is a graduate of the North Carolina Bank Directors' College and attended the initial Advanced Directors' Training session offered by the NC Bank Directors' College in association with the College of Management at North Carolina State University. Dr. Price was previously the owner/pharmacist of Conover Drug Company.

We have no reason to believe that any of the nominees for election will be unable or will decline to serve if elected. In the event of death or disqualification of any nominee or the refusal or inability of any nominee to serve as a director, however, the proxies will vote for the election of another person as they determine in their discretion or may allow the vacancy to remain open until filled by the Board. In no circumstance will any proxy be voted for more than two nominees who are not named in this proxy statement. Properly executed and returned proxies, unless revoked, will be voted as directed by you or, in the absence of direction, will be voted in favor of the election of the recommended nominees. An affirmative vote of a plurality of votes cast at the Annual Meeting is necessary to elect a nominee as a director.

OUR BOARD OF DIRECTORS AND ITS COMMITTEES

How often did our Board of Directors meet during 2009?

Our Board held 14 meetings during 2009. All incumbent directors attended more than 75% of the total number of meetings of the Board and its committees on which they served during the year.

What committees does our Board have?

During 2009, our Board had four standing committees, the Audit Committee, the Governance Committee, the Compensation Committee, and the Executive Committee. The voting members of these Committees are appointed by the Board annually from among its members. Certain of our executive officers also serve as non-voting, advisory members of these committees.

Executive Committee. The Executive Committee performs duties as assigned by the full Board of Directors. Actions taken by the Executive Committee must be approved by the full Board. The Executive Committee consists of Directors R. Abernethy, J. Abernethy, Lineberger, Matthews and Howard, as well as Mr. Wolfe, the President and Chief Executive Officer of the Company. It meets on an "as needed" basis and met two times during 2009.

Governance Committee. The Governance Committee is comprised entirely of independent directors, as defined in Rule 4200(a)(15) of the NASDAQ's listing standards. During fiscal year 2009 the following persons served on the Committee: Directors R. Abernethy, J. Abernethy, Lineberger, Robinson, Terry, and Timmerman. The Governance Committee is responsible for developing and maintaining the corporate governance policy, as well as acting as the nominating committee for the Board.

The Governance Committee, serving as the nominating committee of the Board of Directors, interviews candidates for membership to the Board of Directors, recommends candidates to the full Board, slates candidates for shareholder votes, and fills any vacancies on the Board of Directors which occur between shareholder meetings. The Governance Committee's identification of candidates for director typically results from the business interactions of the members of the Governance Committee or from recommendations received by the committee from other Directors or from Company management.

The Governance Committee currently has no written policy with regard to the consideration of director candidates recommended by security holders. If a security holder recommends a director candidate to the Governance Committee, however, the Governance Committee will consider the candidate and apply the same considerations that it would to its own candidates. The recommendation of a candidate by a security holder should be made in writing, addressed to the attention of the Governance Committee at the Company’s corporate headquarters.

The recommendation should include a description of the candidate's background, his or her contact information, and any other information the security holder considers useful and appropriate for the Governance Committee's consideration of the candidate. The criteria which have been established by the Governance Committee as bearing on the consideration of a candidate's qualification to serve as a director include the following: the candidate's ethics, integrity, involvement in the community, success in business, relationship with the Bank, investment in the Company, place of residence (i.e., proximity to the Bank's market area), and financial expertise.

The Governance Committee has no written diversity policy; however, the Governance Committee considers diversity of professional experience, skills and other individual qualities and attributes that contribute to board heterogeneity. While there are currently no women or minorities serving on the Board, any qualified candidate receives consideration regardless of race, gender or national origin.

The Governance Committee met one time during fiscal year 2009.

A copy of the Company's Governance Committee Charter, which contains the Company's and the Bank's governance policies and nomination policies, is reviewed annually and amended as needed, by the Committee. Shareholders may obtain a copy of the Governance Committee Charter from the Bank's website (www.peoplesbanknc.com) under Investor Relations.

Audit Committee. The Company has a separately designated standing audit committee which was established in accordance with Section 3(a)(58)(A) of the Exchange Act. The Committee has a written charter which is reviewed annually, and amended as needed, by the Committee. A copy of the Audit Committee Charter is available on the Bank's website (www.peoplesbanknc.com) under Investor Relations. The Audit Committee consists of Directors R. Abernethy, Howard, Matthews, Price, Timmerman and Zachary. The Board of Directors has determined that these members are independent as that term is defined in Rule 4200(a)(15) of the NASDAQ's listing standards.

The Board of Directors has determined that each member of the Audit Committee named above qualifies as an "audit committee financial expert" based on each of the member's educational background and business experience.

The Audit Committee meets at least quarterly and, among other responsibilities, oversees (i) the independent auditing of the Company; (ii) the system of internal controls that management has established; and (iii) the quarterly and annual financial information to be provided to shareholders and the Securities and Exchange Commission. The Audit Committee met ten times during the fiscal year ended December 31, 2009.

REPORT OF AUDIT COMMITTEE

The Audit Committee has reviewed and discussed the audited financial statements with management of the Company and has discussed with the independent auditors the matters required to be discussed by Auditing Standards No. 61 as amended (AICPA, Professional Standards, Vol. 1 AU section 380), as adopted by the Public Company Accounting Oversight Board in Rule 3200T. In addition, the Committee has received the written disclosures and the letter from the independent accountants required by the applicable requirements of the Public Company Accounting Oversight Board regarding the independent accountant's communications with the audit committee concerning independence, and has discussed with the independent accountant the independent accountant's independence. Based upon these reviews and discussions, the Committee recommended to the Board of Directors that the audited financial statements be included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

	Robert C. Abernethy	Douglas S. Howard	

Benjamin I. Zachary	Dan R. Timmerman, Sr.
Gary E. Matthews	Dr. Billy L. Price, Jr.

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Compensation Committee. The Company's Compensation Committee is responsible for reviewing the Bank's salary programs and recommendations to the Company's and the Bank's board of directors regarding compensation of the executive officers. Upon recommendation from the Compensation Committee, the Company's Board of Directors ultimately determines such compensation.

All of the members of the Compensation Committee are independent as defined in Section 4200(a)(15) of the NASDAQ's listing standards. The Board of Directors determines on an annual basis each director's independence. The members of the Compensation Committee in fiscal year 2009 were Directors R. Abernethy, J. Abernethy, Lineberger, Robinson, Terry and Timmerman. The Compensation Committee is responsible for developing, implementing and maintaining the Company's and the Bank's compensation policies. The Compensation Committee met five times during the fiscal year ended December 31, 2009.

A copy of the Company's Compensation Committee Charter, which contains the Company's and the Bank's compensation policies and nomination policies, is reviewed annually and amended as needed, by the Committee and is available on the Bank's website (www.peoplesbanknc.com) under Investor Relations.

In 2009, the Committee engaged a compensation consultant, Matthews Young, to help evaluate the Company's compensation design, process and decisions. Fees paid to Matthews Young did not exceed $120,000. Tony Wolfe, President and CEO of the Company and the Bank, makes recommendations to the Committee regarding the compensation of the executive officers. Mr. Wolfe participates in the deliberations, but not in the decisions, of the Committee regarding compensation of executive officers other than him. He does not participate in the Committee's discussion or decisions regarding his own compensation.

The overall objective of our compensation program is to align total compensation so that the individual executive believes it is fair and equitable and provides the highest perceived value to our shareholders and to that individual. In order to accomplish this overall objective, our compensation program is designed to: (i) attract the qualified executives necessary to meet our needs as defined by the Company's strategic plans, and (ii) retain and motivate executives whose performance supports the achievement of our long-term plans and short-term goals.

The Committee considers a number of factors specific to each executive's role when determining the amount and mix of compensation to be paid. These factors are:

- Compensation of the comparable executives at comparable financial institutions;
- Financial performance of the Company (especially on a "net operating" basis, which excludes the effect of one-time gains and expenses) over the most recent fiscal year and the prior three years;
- Composition of earnings;
- Asset quality relative to the banking industry;
- Responsiveness to the economic environment;
- The Company's achievement compared to its corporate, financial, strategic and operational objectives and business plans; and
- Cumulative shareholder return.

The Company's and the Bank's compensation program consists of the following elements:

(i) Base Salary. The salaries of our NEOs are designed to provide a reasonable level of compensation that is affordable to the Company and fair to the executive. Salaries are reviewed annually, and adjustments, if any, are made based on the review of competitive salaries in our peer group, as well as an evaluation of the individual officer's responsibilities, job scope, and individual performance. For example, we assess each officer's success in achieving budgeted earnings and return ratios, business conduct and integrity, and leadership and team building skills.

(ii) Annual Cash Incentive Awards. We believe that annual cash incentive awards encourage our NEOs to achieve short–term targets that are critical to achievement of our strategic plan. The following officers are eligible to receive annual cash incentive awards under our Management Incentive Plan, which provides for cash awards to the following NEOs upon achievement of certain financial objectives:

- Tony W. Wolfe, President and Chief Executive Officer
- A. Joseph Lampron, Executive Vice President and Chief Financial Officer
- Lance A. Sellers, Executive Vice President and Chief Credit Officer
- William D. Cable, Sr., Executive Vice President and Chief Operating Officer
- Joseph F. Beaman, Jr., Executive Vice President, Chief Administrative Officer and Corporate Secretary

We seek to ensure that a significant portion of each executive officer’s total annual cash compensation is linked to the attainment of the annual performance objectives determined by the executive officer and the Compensation Committee under the Management Incentive Plan.

(iii) Discretionary Bonus and Service Awards. From time to time the Compensation Committee may recommend to the Board that additional bonuses be paid based on accomplishments that significantly exceed expectations during the fiscal year. These bonuses are totally discretionary as to who will receive a bonus and the amount of any such bonus. No discretionary bonuses were awarded to NEOs in 2009. The Bank gives service awards to each employee and director for every five years of service with the Bank to promote longevity of service for both directors and employees. Service awards are made in the form of shares of the Company’s common stock. The number of shares awarded increases with the number of years of service to the Bank.

(iv) Long-Term Equity Incentive Awards. The Company maintains the 2009 Omnibus Stock Ownership and Long Term Incentive Plan (“Omnibus Plan”), under which it is permitted to grant incentive stock options, restricted stock, restricted stock units, stock appreciation rights, book value shares, and performance units. The purpose of the Omnibus Plan is to promote the interests of the Company by attracting and retaining directors and employees of outstanding ability and to provide executives of the Company greater incentive to make material contributions to the success of the Company by providing them with stock-based compensation which will increase in value based upon the market performance of the common stock and/or the corporate achievement of financial and other performance objectives. No rights under the Omnibus Plan were granted to any NEO in 2009. The Compensation Committee is reviewing the use of long-term equity incentives, with the intent to associate the vesting of awards to the achievement of selected financial performance goals.

Under the terms of the Omnibus Plan, option exercise prices are always based upon the closing trading price of the Company’s common stock on the date of grant by the Board of Directors.

(v) Retirement Benefits. The Company maintains supplemental retirement agreements (SERPs) for the benefit of Messrs. Wolfe, Lampron, Sellers, Cable and Beaman. The Committee's goal is to provide competitive retirement benefits given the restrictions on executives within tax-qualified plans. The Committee worked with Matthews Young in analyzing the possible benefits of using SERPs to address the issues of internal and external equity in terms of retirement benefits offered to all employees at the Company as a percentage of final average pay and executives in our peer group. The Committee approved supplemental retirement benefits targeting 40% of the final average pay for all NEOs. The Committee selected a target of 40% to match such benefits offered to other employees fully participating in qualified retirement plans offered by the Company. For more information on the SERPs, see page 28 of this Proxy Statement.

(vi) Severance Benefits. The Company has employment agreements with our NEOs which provide, among other things, for severance benefits upon certain types of employment terminations. We believe employment agreements serve a number of functions, including (i) retention of our executive team; (ii) mitigation of any uncertainty about future employment and continuity of management in the event of a change in control; and (iii) protection of the Company and customers through non-compete and non-solicitation covenants. Additional information regarding the employment agreements, including a description of key terms may be found on page 22 of this Proxy Statement.

In October 2008, President George Bush signed into law the Emergency Economic Stabilization Act ("EESA") which gave the US Treasury the authority to develop programs that would stabilize the U.S. financial institutions. Pursuant to this authority, the US Treasury developed the Troubled Asset Relief Program ("TARP") which includes the Capital Purchase Program ("CPP"). On December 23, 2008, the US Treasury under the CPP invested $ 25,054,000 million in the Company's preferred stock and common stock warrants. As a participant in the CPP, we have adopted certain requirements for executive compensation and corporate governance in accordance with the US Treasury's interim final rule implementing the compensation and corporate governance requirements under EESA, as amended by the American Recovery and Reinvestment Act of 2009, as well as additional guidance issued by the US Treasury from time to time following the issuance of the interim final rule. These rules were subject to a public comment period which has expired, but no final rule has been adopted. The rules in part (a) limit compensation to exclude incentives for senior executive officers to take unnecessary and excessive risks that threaten the value of the financial institution (b) provide for the recovery of any bonus, retention award or incentive compensation paid to certain employees based on statements of earnings, revenues, gains or other criteria that are later found to be materially inaccurate, (c) prohibit any golden parachute payment to a senior executive officer or any of the next five most highly compensated employees and (d) prohibit the payment or accrual of any bonus, retention award, or incentive compensation to certain employees, except that any such restriction does not apply to the payment of long-term restricted stock that meets specified conditions including a limit on value to one-third of the total amount of annual compensation of the employee receiving the stock. Under the CPP rules, the term "senior executive officer" is defined as the Chief Executive Officer, Chief Financial Officer and the next three most highly compensated employees. In 2008 at the time of entering into the CPP, each of the Company's named executive officers signed an agreement with the Company agreeing to modify their compensation arrangements to the extent applicable to comply with these requirements. The CPP requirements remain in effect during the period that the US Treasury holds equity or debt securities of the Company.

The current compensation program has been and will continue to be limited as necessary to comply with the CPP restrictions including the elimination of cash bonuses and accruals, limiting the value of equity compensation awards, and the elimination of parachute payments as well as the other restrictions described above.

Participation in the CPP also required that the Compensation Committee, in conjunction with the Company's senior risk officer, at least every six month discuss, evaluate, and review (1) the Company's senior executive officer ("SEO") compensation plans to ensure that those plans do not encourage the SEOs to take unnecessary and excessive risks that threaten the value of the Company, (2) the Company's employee compensation plans in light of the risks posed to the Company by such plans and how to limit such risks, and (3) the Company's employee compensation plans to ensure that those plans do not encourage the manipulation of the Company's reported earnings to enhance the compensation of any employee. Further, the Compensation Committee must annually provide a narrative description of how the SEO compensation plans do not encourage the SEOs to take unnecessary and excessive risks that threaten the value of the Company (including how the SEO plans do not encourage behavior focused on short-term results rather than long-term value creation), the risks posed by the employee compensation plans and how these risks were limited (including how the employee compensation plans do not encourage behavior focused on short-term results rather that long-term value creation), and how the Company has ensured that the employee compensation plans do not encourage the manipulation of the Company's reported earnings to enhance the compensation of any employee. Within this framework, a variety of topics were discussed including:

- The parameters of acceptable and excessive risk taking in light of a number of considerations, including the understanding that some risk taking is an inherent part of the operations of a financial institution;
- The other controls that the Company and the Bank have established (other than reviews of the Company's compensation practices) that limit undesirable risk taking; and
- The general business goals and concerns of the Company, ranging from growth and profitability to the need to attract, retain and incentivize top tier talent.

As a result of this review and discussion, it was determined by the committee that the design and goals of the existing SEO and employee incentive compensation arrangements do not create an incentive for the SEOs or employees to engage in unnecessary and excessive risk taking; encourage behavior that is focused on short-term results rather than long-term value creation; or encourage the manipulation of the Company's reported earnings to enhance the compensation of any employee. The Committee believes that the discretionary nature of its decision-making process in determining the amount of any incentive compensation awards based upon its after-the-fact assessment of a variety of financial and other performance factors serves to mitigate the potential for excessive risk taking.

Compensation Committee Interlocks and Insider Participation

No member of the Compensation Committee is now, or formerly was, an officer or employee of the Company or the Bank. None of the NEOs serves as a member of the board of directors of another entity whose executive officers or directors serve on the Company's Board of Directors.

Board Leadership Structure and Risk Oversight

Our Company and the Bank have traditionally operated with separate Chief Executive Officer and Chairman of the Board positions. We believe it is our chief executive officer's responsibility to manage the Company and the chairman's responsibility to lead the Board. Robert Abernethy is currently serving as Chairman of the Board. All of the members of the Board of Directors are independent under NASDAQ listing requirements. The Company has four standing committees: Executive, Governance, Audit and Compensation. All but the Executive Committee is made up entirely of independent directors. Mr. Wolfe, the Chief Executive Officer, serves on the Executive Committee. The Bank in addition to the above-named committees has a Loan Committee. The duties of the Company's committees and the qualifications of the independent directors have been described above. Each of the Company's and the Bank's committees considers risk within its area of responsibility. The Audit Committee and the full Board focus on the Company's most significant risks in the areas of liquidity, credit, interest rate and general risk management strategy. The Board sets policy guidelines in the areas of loans and asset/liability management which are reviewed on an on-going basis. While the Board oversees the Company's risk management, the Company's and the Bank's management are responsible for day-to-day risk management following the dictates of the Board's policy decisions.

The Governance Committee, as part of its annual review, evaluates the Board leadership structure and Board performance and reports its findings to the whole Board. The Board believes that having separate persons serving as chief executive officer and chairman and all independent directors provides the optimal board leadership structure for our Company and our shareholders.

Does the Company have a Code of Ethics?

The Company and the Bank have a Code of Business Conduct and Ethics for its directors, officers and employees. The Code of Business Conduct and Ethics requires that individuals avoid conflicts of interest, comply with all laws and other legal requirements, conduct business in an honest and ethical manner and otherwise act with integrity and in the best interests of the Company and the Bank. The Code of Business Conduct and Ethics is a guide to help ensure that all employees live up to the highest ethical standards.

A copy of the Code of Business Conduct and Ethics is available on the Company's website at www.peoplesbanknc.com.

As is permitted by SEC rules, the Company intends to post on its website any amendment to or waiver from any provision in the Code of Ethics for CEO and Senior Financial Officers that applies to the chief executive officer, the chief financial officer, the controller, or persons performing similar functions, and that relates to any element of the standards enumerated in the rules of the SEC.

How can you communicate with the Board or its members?

We do not have formal procedures for shareholder communication with our Board. In general, our directors and officers are easily accessible by telephone, postal mail or e-mail. Any matter intended for your Board, or any individual director, can be directed to Tony Wolfe, our President and Chief Executive Officer or Joe Lampron, our Chief Financial Officer, at our principal executive offices 518 West C Street, Newton, North Carolina 28658. You also may direct correspondence to our Board, or any of its members, in care of the Company at the foregoing address. Your communication will be forwarded to the intended recipient unopened.

What is our policy for director attendance at Annual Meetings?

Although it is customary for all of our directors to attend Annual Meetings of Shareholders, we have no formal policy in place requiring attendance. All Board members attended our 2009 Annual Meeting of Shareholders held on May 7, 2009.

How can a shareholder nominate someone for election to the Board?

Our Bylaws provide that in order to be eligible for consideration at the Annual Meeting of Shareholders, all nominations of directors, other than those made by the Nominating Committee or the Board of Directors, must be in writing and must be delivered to the Secretary of the Company not less than fifty days nor more than ninety days prior to the meeting at which such nominations will be made. However, if less than sixty days' notice of the meeting is given to the shareholders, such nominations must be delivered to the Secretary of the Company not later than the close of business on the tenth day following the day on which the notice of meeting was mailed.

The Board may disregard any nominations that do not comply with these requirements. Upon the instruction of the Board, the inspector of voting for the Annual Meeting may disregard all votes cast for a nominee if the nomination does not comply with these requirements. Written notice of nominations should be directed to the Secretary of the Company.

Who serves on the Board of Directors of the Bank?

The Bank has ten directors currently serving on its board of directors, who are the same people who are currently Directors of the Company.

DIRECTOR AND EXECUTIVE COMPENSATION AND BENEFITS

Director Compensation

Directors' Fees. Members of the Board of Directors receive no fees or compensation for their service. However, all members of the Board of Directors are also directors of the Bank and are compensated for that service. Directors reduced their fees in 2009 and now receive a fee of $600 for each Bank board of directors meeting attended. An additional fee of $300 is paid to committee members for each committee meeting attended. In addition to these meeting fees, each director also received an annual retainer of $9,000. The Chairman of the Bank's board of directors receives as additional $250 per meeting attended and the chairpersons of each committee receive an additional $150 per meeting attended. Directors who are members of the board of directors of Real Estate Advisory Services, Inc., and Peoples Investment Services, Inc., subsidiaries of the Bank, and Community Bank Real Estate Solutions, Inc., a subsidiary of the Holding Company, received $500 per board meeting. Beginning in 2009, directors received $375 for special meetings via conference call rather than the normal committee or Board meeting fee.

The Bank maintains a Service Recognition Program, under which directors, officers and employees are eligible for awards. Under this Program, directors, officers and employees are awarded a combination of common stock of the Company and cash, with the amount of the award based upon the length of service to the Bank. Any common stock awarded under the Program is purchased by the Bank on the open market, and no new shares are issued by the Company under the Service Recognition Program.

Directors' Stock Benefits Plan. Members of the Board of Directors are eligible to participate in the Company's Omnibus Stock Ownership and Long Term Incentive Plan (the "Omnibus Plan"). Each director has been awarded 9,737 book value shares. These shares are fully vested and the value of the shares was paid out to all directors during 2009.

Directors' Deferred Compensation Plan. In January 2002, the Bank established a non-qualified deferred compensation plan for all of its directors. The Bank's directors are also directors of the Company. Under this plan, each director may defer all or a portion of his fees to the plan each year. The director may elect to invest the deferred compensation in a restricted list of eleven investment funds. The Bank may make matching contributions to the plan for the benefit of the director from time to time at the discretion of the Bank. Directors are fully vested in all amounts they contribute to the plan and in any amounts contributed by the Bank. The Bank has established a Rabbi Trust to hold the directors' accrued benefits under the plan. Plan assets are invested as directed by each director. There are no "above-market" returns provided for in this Plan.

Benefits under the plan are payable in the event of the director's death, resignation, removal, failure to be re-elected, retirement or in cases of hardship. Directors may elect to receive deferred compensation payments in one lump sum or in installments.

Directors' Supplemental Retirement Plan. In January 2002, the Bank implemented a non-qualified supplemental retirement benefits plan for all its directors. The plan is designed to provide a retirement benefit to the directors while at the same time minimizing the financial impact on the Bank's earnings. Under the Plan, the Company purchased life insurance contracts on the lives of each director. The increase in cash surrender value of the contracts constitutes the Company's contribution to the plan each year. The Bank will pay annual benefits to each director for 15 years beginning upon retirement from the Board of Directors. The Bank is the sole owner of all of the insurance contracts.

The following table reports all forms of compensation paid to or accrued for the benefit of each director during the 2009 fiscal year.

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DIRECTOR COMPENSATION

Name	Fees Earned or Paid in Cash ($)	Stock Awards ($)1	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)	Change in Pension Value and Nonqualified Deferred Compensation Earnings2 ($)	All Other Compensation ($)	Total ($)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
James S. Abernethy	23,100	92,477	0	0	3,115	0	118,692
Robert C. Abernethy	31,650	92,477	0	0	4,944	0	129,071
Douglas S. Howard3	25,000	60,518	0	0	1,821	0	87,339
John W. Lineberger, Jr.4	22,950	60,518	0	0	4,787	0	88,255
Gary E. Matthews	22,800	75,234	0	0	2,791	0	100,825
Billy L. Price, Jr., M.D.5	23,150	60,518	0	0	2,492	0	86,160
Larry E. Robinson	22,450	92,477	0	0	9,489	0	124,416
William Gregory Terry6	21,450	60,518	0	0	807	0	82,775
Dan Ray Timmerman, Sr.	27,200	92,477	0	0	7,217	0	126,894
Benjamin I. Zachary	23,050	92,477	0	0	2,506	0	118,033

1 The amount of cash received by directors upon the pay-out of the book value shares.

2 Change in Pension Value and Nonqualified Deferred Compensation Earnings represents the expense accrued by the Bank for each director under the Directors' Supplemental Retirement Plan as described above on page 17 "Directors' Supplemental Retirement Plan."

3, 4, 5, 6 The amount of stock awards received by directors and total amount received by directors includes for directors Howard, Lineberger, Price and Terry, Service Recognition Awards of 47 shares each of the Company's common stock valued at $250.00 on the date of grant and $75.00 in cash.

Executive Officers

Tony W. Wolfe, age 63, serves as President and Chief Executive Officer of the Company and the Bank. He has been employed by the Company and the Bank since 1990, where he served as Vice President-Commercial Loans and Senior Vice President-Lending. Mr. Wolfe served in the past on the boards of directors of the Community Trust of the Southeast and Community Financial Services, Inc., the holding company for The Bankers Bank. Mr. Wolfe has a total of 40 years of banking experience. Mr. Wolfe is a graduate of Lenoir Rhyne University, the North Carolina School of Banking and the School of Banking of the South at Louisiana State University.

Joseph F. Beaman, Jr., age 60, serves as Executive Vice President and Corporate Secretary of the Company and Executive Vice President, Chief Administrative Officer and Secretary of the Bank. He has been employed by the Company and the Bank since 1977, where he has served as Vice President-Operations and Senior Vice President. Mr.

Beaman has a total of 37 years of banking experience. He is a graduate of Pfeiffer University, the North Carolina School of Banking, and the Graduate School of Financial Management at the University of Texas in Austin.

William D. Cable, Sr., age 41, serves as Executive Vice President and Assistant Corporate Treasurer of the Company and Executive Vice President and Chief Operating Officer of the Bank. He has been employed by the Company and the Bank since 1995, where he has served as Senior Vice President-Information Services. Mr. Cable has a total of 18 years of banking experience. Prior to joining the Company, Mr. Cable was a regulatory examiner with the Federal Deposit Insurance Corporation. He is a graduate of Western Carolina University and the School of Banking of the South at Louisiana State University.

Lance A. Sellers, age 47, serves as Executive Vice President and Assistant Corporate Secretary of the Company and Executive Vice President and Chief Credit Officer of the Bank. He has been employed by the Company and the Bank since 1998. Mr. Sellers has a total of 25 years of banking experience. He is a graduate of the University of North Carolina at Chapel Hill and upon graduation served as a senior credit officer at a regional bank headquartered in North Carolina.

A. Joseph Lampron, age 55, serves as Executive Vice President, Chief Financial Officer and Corporate Treasurer of the Company and Executive Vice President and Chief Financial Officer of the Bank. He has been employed by the Company and the Bank since 2001. Mr. Lampron is a graduate of the University of North Carolina at Chapel Hill and upon graduation worked as a CPA with a national accounting firm. His work with the firm included audits of banks and thrift institutions. Mr. Lampron has also served as CFO of a thrift institution and as a senior change manager in the finance group of a large North Carolina bank. Mr. Lampron has a total of 30 years of banking experience.

Management Compensation

The executive officers of the Company are not paid any cash compensation by the Company. However, the executive officers of the Company also are executive officers of the Bank and receive compensation from the Bank.

The table on the following page shows, for the fiscal years ended December 31, 2009 and 2008, the cash compensation received by, as well as certain other compensation paid or accrued for those years, the Bank's Chief Executive Officer and the Bank's executive officers whose total annual salary and bonus exceeded $100,000.

Summary Compensation Table

Name and Principal Position (a)	Year (b)	Salary (c)	Bonus[8] (d)	Stock Awards (e)	Option Awards (f)	Non-Equity Incentive Plan Compensation (g)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (h)	All Other Compensation[1] (i)	Total (j)
Tony W. Wolfe	2009	$290,000	$0	$0	$0	$0	$303,989	$37,737[2]	$631,726
President and Chief Executive Officer	2008	$290,000	$79,000	$0	$0	$0	$141,785	$38,574[2]	$549,359
A. Joseph Lampron	2009	$152,934	$0	$0	$0	$0	$22,446	$12,660[3]	$188,040
Executive Vice President, Chief Financial Officer	2008	$152,934	$33,100	$0	$0	$0	$15,349	$12,328[3]	$213,706
Joseph F. Beaman, Jr.	2009	$125,373	$0	$0	$0	$0	$30,200	$12,493[4]	$168,066
Executive Vice President, Chief Administrative Officer and Corporate Secretary	2008	$125,373	$25,000	$0	$0	$0	$19,453	$12,617[4]	$187,443
Lance A. Sellers	2009	$194,371	$0	$0	$0	$0	$17,504	$19,608[5]	$231,483
Executive Vice President, Chief Credit Officer	2008	$194,371	$42,500	$650[7]	$0	$0	$12,033	$20,208[5]	$269,762
William D. Cable, Sr.	2009	$156,835	$0	$0	$0	$0	$5,599	$13,019[6]	$175,453
Executive Vice President, Chief Operating Officer	2008	$156,835	$33,100	$0	$0	$0	$3,767	$13,590[6]	$207,292

1 Perquisites for the fiscal year did not exceed $10,000 for any NEO other than Mr. Wolfe.

2 For Mr. Wolfe, includes for 2009: $12,250 under the 401(k) plan, $2,772 premium paid for group term life insurance in excess of $50,000 and $2,115 paid for the Split Dollar Death Benefit, and perquisites consisting of country club dues of $3,768, car allowance of $690, disability insurance premium of $15,662 and cell phone allowance of $480 and for 2008: $11,074 under the 401(k) plan, $4,213 premium paid for group term life insurance in excess of $50,000 and $1,860 paid for the Split Dollar Death Benefit, and perquisites consisting of country club dues of $3,650, car allowance of $535, spouse attendance at conference of $500, disability insurance premium of $15,662 and cell phone allowance of $1,080.

3 For Mr. Lampron, includes for 2009: $7,647 under the 401(k) plan, $1,321 premium paid for group term life insurance in excess of $50,000 and $352 paid for the Split Dollar Death Benefit and for 2008: $7,909 under the 401(k) plan, $707 premium paid for group term life insurance in excess of $50,000 and $342 paid for the Split Dollar Death Benefit.

4 For Mr. Beaman, includes for 2009: $6,269 under the 401(k) plan, $1,600 premium paid for group term life insurance in excess of $50,000 and $377 paid for the Split Dollar Death Benefit and for 2008: $6,498 under the 401(k) plan, $1,042 premium paid for group term life insurance in excess of $50,000 and $347 paid for the Split Dollar Death Benefit.

5 For Mr. Sellers, includes for 2009: $9,719 under the 401(k) plan, $612 premium paid for group term life insurance in excess of $50,000 and $308 paid for the Split Dollar Death Benefit and for 2008: $10,052 under the 401(k) plan, $612 premium paid for group term life insurance in excess of $50,000 and $326 paid for the Split Dollar Death Benefit.

6 For Mr. Cable, includes for 2009: $7,842 under the 401(k) plan, $317 premium paid for group term life insurance in excess of $50,000 and $108 paid for the Split Dollar Death Benefit and for 2008: $8,111 under the 401(k) plan, $317 premium paid for group term life insurance in excess of $50,000 and $112 paid for the Split Dollar Death Benefit.

7 Mr. Sellers completed 10 years of service with the Bank in 2008. He received a service award of 44 shares of the Company's common stock and cash for a total value on the grant date of $650.

8 After the US Treasury published its interim rules on executive compensation, the Company paid to the named executive officers bonus amounts accrued prior to its participating in the CPP.

Employment Agreements

The Bank has entered into employment agreements with Tony W. Wolfe, President and Chief Executive Officer; Joseph F. Beaman, Jr., Executive Vice President, Chief Administrative Officer and Corporate Secretary; Lance A. Sellers, Executive Vice President, Chief Credit Officer and Assistant Corporate Secretary; A. Joseph Lampron, Executive Vice President, Chief Financial Officer and Corporate Treasurer; and William D. Cable, Sr., Executive Vice President, Chief Operating Officer and Assistant Corporate Treasurer, in order to establish their duties and compensation and to provide for their continued employment with the Bank. The agreements provide for an initial term of employment of three years. Commencing on the first anniversary date and continuing on each anniversary date thereafter, unless notice of a non-extension is given by either party, each agreement is automatically extended for an additional year so that the remaining term is always no less than two and no more than three years. The agreements also provide that the base salary will be reviewed by the Board of Directors not less often than annually. In addition, the employment agreements provide for discretionary bonuses and participation in other management incentive, pension, profit-sharing, medical or retirement plans maintained by the Bank, as well as fringe benefits normally associated with such employee’s office. Mr. Wolfe’s agreement provides for a company automobile. The employment agreements provide that they may be terminated by the Bank for cause, as defined in the agreements, and that they may otherwise be terminated by the Bank (subject to vested rights) or by the employee.

In the event of a change in control, the term of the employment agreements will be automatically extended for three years from the date of the change of control. For purposes of the employment agreement, a change in control generally will occur if (i) any “person” (as such term is used in Section 13(d) and 14(d) of the Exchange Act), other than a person who beneficially owned as of January 1, 1998, more than 5% of the Bank’s securities, acquires beneficial ownership of voting stock and irrevocable proxies representing 20% or more of any class of voting securities of either the Company or the Bank, (ii) the election of directors constituting more than one-half of the Board of Directors of the Company or the Bank who, prior to their election, were not nominated for election or approved by at least three-fourths of the Board of Directors of the Company as then constituted; (iii) either the Company or the Bank consolidates or merges with or into another corporation, association or entity or is otherwise reorganized, where neither the Company nor the Bank, respectively, is the surviving corporation in the transaction; or (iv) all or substantially all of the assets of either the Company or the Bank are sold or otherwise transferred to or acquired by any other entity or group.

In addition, the employee may voluntarily terminate his employment at any time following a change in control and continue to receive his base salary for the remainder of the term of the employment agreement, if, after the change in control, (i) the employee is assigned duties and/or responsibilities that are inconsistent with his position prior to the change in control or that are inconsistent with his reporting responsibilities at that time, (ii) the employee’s compensation or benefits are reduced, or (iii) the employee is transferred, without his consent, to a location which is an unreasonable distance from his current principal work location.

An additional thirteen (13) middle management officers had employment agreements during 2009. The term of these agreements is until December 1, 2010, renewed annually and the agreements contain provisions similar to those discussed above.

Under the terms of the CPP, none of the named executive officers would have been entitled to payments had a change in control occurred during 2009.

Omnibus Stock Option and Long Term Incentive Plan

The purpose of the Omnibus Plan is to promote the interests of the Company by attracting and retaining directors and employees of outstanding ability and to provide executive and other key employees of the Company and its subsidiaries greater incentive to make material contributions to the success of the Company by providing them with stock-based compensation which will increase in value based upon the market performance of the common stock and/or the corporate achievement of financial and other performance objectives.

Rights Which May Be Granted. Under the Omnibus Plan, the Committee may grant or award eligible participants stock options, rights to receive restricted shares of common stock, restricted stock units, performance units (each equivalent to one share of common stock), SARs, and/or book value shares. These grants and awards are referred to herein as the "Rights." All Rights must be granted or awarded by February 19, 2019, the tenth anniversary of the date the Board of Directors adopted the Omnibus Plan. The Board of Directors has provided for 360,000 shares of the Company's common stock be included in the Omnibus Plan to underlie Rights which may be granted thereunder.

Options. Options granted under the Omnibus Plan to eligible directors and employees may be either incentive stock options ("ISOs") or non-qualified stock options ("NSOs"). The exercise price of an Option may not be less than 100% of the last-transaction price for the common stock quoted by the NASDAQ Market on the date of grant.

Restricted Stock and Restricted Stock Units. The Committee may award Rights to acquire shares of common stock or restricted stock units, subject to certain transfer restrictions ("Restricted Stock" or "Restricted Stock Unit") to eligible participants under the Omnibus Plan for such purchase price per share, if any, as the Committee, in its discretion, may determine appropriate. The Committee will determine the expiration date for each Restricted Stock or Restricted Stock Unit award, up to a maximum of ten years from the date of grant. In the Committee's discretion, it may specify the period or periods of time within which each Restricted Stock or Restricted Stock Unit award will first become exercisable, which period or periods may be accelerated or shortened by the Committee. Under the terms of the Omnibus Plan, the Committee also has the discretion to pay out awards of Restricted Stock or Restricted Stock Units in the Company's common stock, cash or a combination of stock and cash.

Performance Units. Under the Omnibus Plan, the Committee may grant to eligible directors and employees awards of long term incentive performance units, each equivalent in value to one share of common stock ("Units"). Except as otherwise provided, Units awarded may be distributed only after the end of a performance period of two or more years, as determined by the Committee, beginning with the year in which the awards are granted.

The percentage of the Units awarded that are to be distributed will depend on the level of financial and other performance goals achieved by the Company during the performance period. The Committee may adopt one or more performance categories in addition to, or in substitution for, a performance category or may eliminate all performance categories other than financial performance.

As soon as practicable after each performance period, the percentage of Units awarded that are to be distributed, based on the levels of performance achieved, will be determined and distributed to the recipients of such awards in the form of a combination of shares of common stock and cash or cash only. Units awarded, but which the recipients are not entitled to receive, will be cancelled.

In the event of the death or disability of a Unit recipient prior to the end of any performance period, the number of Units awarded for such performance period will be reduced in proportion to the number of months remaining in the performance period after the date of death or disability. The remaining portion of the award, if any, may, in the discretion of the Committee, be adjusted based upon the levels of performance achieved prior to the date of death or disability, and distributed within a reasonable time after death or disability. In the event a recipient of Units ceases to be an eligible director or employee for any reason other than death or disability, all Units awarded, but not yet distributed, will be cancelled.

In the event of a change in control (as that term is defined in the Omnibus Plan), any outstanding Units will immediately and automatically be reduced as appropriate to reflect a shorter performance period.

An amount equal to the dividend payable on one share of common stock (a "dividend equivalent credit") will be determined and credited on the payment date to each Unit recipient's account for each Unit awarded and not yet distributed or cancelled. Such amount will be converted within the account to an additional number of Units equal to the number of shares of common stock which could be purchased at the last-transaction price of the common stock on the NASDAQ Market on the dividend payment date.

No dividend equivalent credits or distribution of Units may be credited or made if, at the time of crediting or distribution, (i) the regular quarterly dividend on the common stock has been omitted and not subsequently paid or there exists any default in payment of dividends on any such outstanding shares of common stock; (ii) the rate of dividends on the common stock is lower than at the time the Units to which the dividend equivalent credit relates were awarded, adjusted for certain changes; (iii) estimated consolidated net income of the Company for the twelve-month period preceding the month the dividend equivalent credit or distribution would otherwise have been made is less than the sum of the amount of the dividend equivalent credits and Units eligible for distribution under the Omnibus Plan in that month plus all dividends applicable to such period on an accrual basis, either paid, declared or accrued at the most recently paid rate, on all outstanding shares of common stock; or (iv) the dividend equivalent credit or distribution would result in a default in any agreement by which the Company is bound.

If an extraordinary event occurs during a performance period which significantly alters the basis upon which the performance levels were established, the Committee may make adjustments which it deems appropriate in the performance levels. Such events may include changes in accounting practices, tax, financial institution laws or regulations or other laws or regulations, economic changes not in the ordinary course of business cycles, or compliance with judicial decrees or other legal requirements.

Stock Appreciation Rights. The Omnibus Plan provides that the Committee may award to eligible directors and employees Rights to receive cash based upon increases in the market price of common stock over the last transaction price of the common stock on the NASDAQ Market (the “Base Price”) on the date of the award. The Committee may adjust the Base Price of a SAR based upon the market value performance of the common stock in comparison with the aggregate market value performance of a selected index or at a stated annual percentage rate. The expiration date of a SAR may be no more than ten years from the date of award.

Each SAR awarded by the Committee may be exercisable immediately or may become vested over such period or periods as the Committee may establish, which periods may be accelerated or shortened in the Committee's discretion. Each SAR awarded will terminate upon the expiration date established by the Committee, termination of the employment or directorship of the SAR recipient, or in the event of a change in control, as described above in connection with the termination of Options.

Book Value Shares. The Omnibus Plan provides that the Committee may award to eligible directors and eligible employees long term incentive units, each equivalent in value to the book value of one share of common stock on the date of award (“Book Value Shares”). The Committee will specify the period or periods of time within which each Book Value Share will vest, which period or periods may be accelerated or shortened by the Committee. Upon redemption, the holder of a Book Value Share will receive an amount equal to the difference between the book value of the common stock at the time the Book Value Share is awarded and the book value of the common stock at the time the Book Value Share is redeemed, adjusted for the effects of dividends, new share issuances, and mark-to-market valuations of the Company’s investment securities portfolio in accordance with FASB 115.

The expiration date of each Book Value Share awarded will be established by the Committee, up to a maximum of ten years from the date of award. However, awards of Book Value Shares will earlier terminate in the same manner as described above in connection with the termination of Options.

Adjustments. In the event the outstanding shares of the common stock are increased, decreased, changed into or exchanged for a different number or kind of securities as a result of a stock split, reverse stock split, stock dividend, recapitalization, merger, share exchange acquisition, or reclassification, appropriate proportionate adjustments will be made in (i) the aggregate number or kind of shares which may be issued pursuant to exercise of, or which underlie, Rights; (ii) the exercise or other purchase price, or Base Price, and the number and/or kind of shares acquirable under, or underlying, Rights; and (iii) rights and matters determined on a per share basis under the Omnibus Plan. Any such adjustment will be made by the Committee, subject to ratification by the Board of Directors. As described above, the Base Price of a SAR may also be adjusted by the Committee to reflect changes in a selected index. Except with regard to Units and Book Value Shares awarded under the Omnibus Plan, no adjustment in the Rights will be required by reason of the issuance of common stock, or securities convertible into common stock, by the Company for cash or the issuance of shares of common stock by the Company in exchange for shares of the capital stock of any corporation, financial institution or other organization acquired by the Company or a subsidiary thereof in connection therewith.

Any shares of common stock allocated to Rights granted under the Omnibus Plan which are subsequently cancelled or forfeited will be available for further allocation upon such cancellation or forfeiture.

Federal Income Tax Consequences

Options. Under current provisions of the Code, the federal income tax treatment of ISOs and NSOs is different. Options granted to employees under the Omnibus Plan may be ISOs which are designed to result in beneficial tax treatment to the employee but not a tax deduction to the Company.

The holder of an ISO generally is not taxed for federal income tax purposes on either the grant or the exercise of the option. However, the optionee must include in his or her federal alternative minimum tax income any excess (the "Bargain Element") of the acquired common stock's fair market value at the time of exercise over the exercise price paid by the optionee. Furthermore, if the optionee sells, exchanges, gives or otherwise disposes of such common stock (other than in certain types of transactions) either within two years after the option was granted or within one year after the option was exercised (an "Early Disposition"), the optionee generally must recognize the Bargain Element as compensation income for regular federal income tax purposes. Any gain realized on the disposition in excess of the Bargain Element is subject to recognition under the usual rules applying to dispositions of property. If a taxable sale or exchange is made after such holding periods are satisfied, the difference between the exercise price and the amount realized upon the disposition of the common stock generally will constitute a capital gain or loss for tax purposes.

Options granted to directors under the Omnibus Plan would be "NSOs." In general, the holder of an NSO will recognize at the time of exercise of the NSO, compensation income equal to the amount by which the fair market value of the common stock received on the date of exercise exceeds the sum of the exercise price and any amount paid for the NSO.

If an optionee exercises an ISO or NSO and delivers shares of common stock as payment for part or all of the exercise price of the stock purchased (the "Payment Stock"), no gain or loss generally will be recognized with respect to the Payment Stock; provided, however, if the Payment Stock was acquired pursuant to the exercise of an ISO, the optionee will be subject to recognizing as compensation income the Bargain Element on the Payment Stock as an Early Disposition if the exchange for the new shares occurs prior to the expiration of the holding periods for the Payment Stock.

The Company generally would not recognize gain or loss or be entitled to a deduction upon either the grant of an ISO or NSO or the optionee's exercise of an ISO. The Company generally will recognize gain or loss or be entitled to a deduction upon the exercise of an NSO. If there is an Early Disposition, the Company generally would be entitled to deduct the Bargain Element as compensation paid to the optionee.

The above and other descriptions of federal income tax consequences are necessarily general in nature and do not purport to be complete. Moreover, statutory provisions are subject to change, as are their interpretations, and their application may vary in individual circumstances. Such descriptions may not be used to avoid any federal tax penalty. Each taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor. Finally, the consequences under applicable state and local income tax laws may not be the same as under the federal income tax laws.

Restricted Stock and Restricted Stock Units. Pursuant to Section 83 of the Code, recipients of Restricted Stock and Restricted Stock Unit awards under the Omnibus Plan will recognize ordinary income in an amount equal to the fair market value of the shares of common stock granted to them at the time that the shares vest and become transferable. The Company will be entitled to deduct as a compensation expense for tax purposes the same amounts recognized as income by recipients of Restricted Stock awards in the year in which such amounts are included in income.

Units. The Company expects that participants generally will not be taxed on the award of Units. Instead, any cash and the then fair market value of any common stock received by the participants upon the distribution of a Unit generally will be taxable to the participants as compensation income upon such distribution. At that time, the Company generally will be entitled to claim a deduction in an amount equal to the compensation income.

SARs. Pursuant to Section 83 of the code, recipients of SARs under the Omnibus Plan will recognize, at the time a SAR award is exercised, ordinary income in an amount equal to the difference between the fair market value of the common stock at the time of award of the SAR and the fair market value of the common stock at the time that the SAR is exercised. The Company will be entitled to deduct as a compensation expense for tax purposes the same amounts recognized as income by recipients of SAR awards in the year in which such amounts are included in income.

Book Value Shares. The Company expects that participants generally will not be taxed on the award of Book Value Shares. Instead, any cash received by the participants upon redemption of the Book Value Shares generally will be taxable to the participant as compensation income upon distribution. At that time, the Company generally will be entitled to claim a deduction in an amount equal to the compensation income.

Incentive Compensation Plans

The Bank also has a Management Incentive Plan for officers and an Employee Incentive Plan for employees of the Bank. Eligibility under the Employee Incentive Plan is granted to all employees upon ninety (90) days of service with the Bank. Participants in the Employee Incentive Plan are entitled to receive quarterly cash incentives based upon a graduated schedule indexed to attainment of corporate budget. Participants in the Management Incentive Plan are recommended annually by the President and Chief Executive Officer to the Bank’s Board of Directors. Each individual’s incentive pool is determined by a formula which links attainment of corporate budget with attainment of individual goals and objectives. Incentives under the Management Incentive Plan are paid annually.

Outstanding Equity Awards at Fiscal Year End. The table below gives information related to equity awards held by the Company's NEOs at the end of fiscal year 2009:

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END

	Option Awards					Stock Awards			
Name	Number of Securities Underlying Unexercised Options (#) Exercisable1	Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#)	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested ($)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
Tony W. Wolfe	17,048 9,075			$8.78 $7.77	10/30/2011 12/17/2012				
A. Joseph Lampron	7,510 10,890			$8.10 $7.77	12/18/2011 12/17/2012				
Joseph F. Beaman, Jr.	10,463 9,041 7,260			$6.99 $8.78 $7.77	10/25/2010 10/30/2011 12/17/2012				
Lance A. Sellers	8,750 12,705			$8.78 $7.77	10/30/2011 12/17/2012				
William D. Cable, Sr.	3,167 6,387 10,890			$6.99 $8.78 $7.77	10/25/2010 10/30/2011 12/17/2012				

1 Securities underlying options have been adjusted for the three-for-two stock split on June 15, 2007.

Deferred Compensation Plan

In January 2002, the Bank established a non-qualified deferred compensation plan for directors and certain officers. Eligible officers selected by the Bank's board of directors may elect to contribute a percentage of their compensation to the plan. The Bank may make matching or other contributions to the plan as well, in amounts determined at the discretion of the Bank. Participants are fully vested in all amounts contributed to the plan by them or on their behalf.

Benefits under the plan are payable in the event of the participant's retirement, death, termination, or as a result of hardship. Benefit payments may be made in a lump sum or in installments, as selected by the participant.

The Bank has established a Rabbi Trust to hold the accrued benefits of the participants under the plan.

Supplemental Retirement Plan

In January 2002, the Bank implemented a non-qualified supplemental retirement benefits plan ("SERP") for certain officers. The plan is designed to provide a retirement benefit to the officers while at the same time minimizing the financial impact on the Bank's earnings. Under the Plan, the Company purchased life insurance contracts on the lives of certain officers. The increase in cash surrender value of the contracts constitutes the Company's contribution to the plan each year. The Bank will pay benefits to participating officers for a period between ten years and the life of the officer. The Bank is the sole owner of all of the insurance contracts. Each of the named executive officers is fully vested in the benefits provided under the SERP.

Discretionary Bonuses and Service Awards

In the past, the Bank has paid bonuses to its employees in amounts determined in the discretion of the Bank's board of directors. The Bank anticipates that discretionary bonuses will continue to be paid to its employees in the future. The Bank also gives service awards to each employee for every five years of service with the Bank. Service awards are made in the form of shares of the Company's common stock. The number of shares awarded increases with the years of service to the Bank.

Profit Sharing Plan and 401(k) Plan

The Bank has a Profit Sharing Plan and 401(k) Plan for all eligible employees. The Bank made no contribution to the Profit Sharing Plan for the year ended December 31, 2009. No investments in Bank stock have been made by the plan.

Under the Bank's 401(k) Plan, the Bank matches employee contributions to a maximum of 5.00% of annual compensation. The Bank's 2009 contribution to the 401(k) Plan pursuant to this formula was approximately $482,000. All contributions to the 401(k) Plan are tax deferred.

The Profit Sharing Plan and 401(k) Plan permit participants to choose from ten investment funds which are selected by a committee comprised of senior management. Both the 401(k) Plan and Profit Sharing Plan were amended in 2000 to permit participation in the plans beginning in the second month of employment. Both plans provide for vesting of 20% of the benefit after two years employment and 20% each year thereafter until participants are 100% vested after six years employment.

Indebtedness of and Transactions with Management and Directors

The Company is a “listed issuer” under the rules and regulations of the Exchange Act whose common stock is listed on NASDAQ. The Company uses the definition of independence contained in NASDAQ’s listing standards to determine the independence of its directors and that the Board of Directors and each standing committee of the Board is in compliance with NASDAQ listing standards for independence.

Certain directors and executive officers of the Bank and their immediate families and associates were customers of and had transactions with the Bank in the ordinary course of business during 2009. All outstanding loans, extensions of credit or overdrafts, endorsements and guarantees outstanding at any time during 2009 to the Bank's executive officers and directors and their family members were made in the ordinary course of its business. These loans are currently made on substantially the same terms, including interest rates and collateral, as those then prevailing for comparable transactions with persons not related to the lender, and did not involve more than the normal risk of collectability or present any other unfavorable features.

The Bank leases two of its facilities from Shortgrass Associates, L.L.C. ("Shortgrass"). Director John W. Lineberger, Jr., owns 25% of the membership interests in Shortgrass. Pursuant to the terms of the leases for the two facilities leased by the Bank, during 2009 the Bank paid a total of $193,725 to Shortgrass in lease payments for these facilities. Each of the facilities is subject to a 20-year lease between the Bank and Shortgrass. The Board of Directors routinely, and no less than annually, reviews all transactions, direct and indirect, between the Company or the Bank and any employee or director, or any of such person's immediate family members. Transactions are reviewed as to comparable market values for similar transactions. All material facts of the transactions and the director's interest are discussed by all disinterested directors and a decision made about whether the transaction is fair to the Company and the Bank. A majority vote of all disinterested directors is required to approve the transaction.

The Board of Directors also evaluates the influence family relationships may have on the independence of directors who are related by blood or marriage. Christine S. Abernethy, a greater than ten percent shareholder of the Company, has two sons, Robert C. Abernethy and James S. Abernethy, who serve on the Board of Directors. All of the non-related directors have determined that the family relationships among Christine S. Abernethy, James S. Abernethy and Robert C. Abernethy do not affect the brothers' independence as directors.

PROPOSAL 2

ADVISORY (NON-BINDING) PROPOSAL TO APPROVE THE COMPENSATION OF THE COMPANY'S NAMED EXECUTIVE OFFICERS

The Company believes that our 2009 compensation policies and procedures are centered on a pay-for-performance culture and are strongly aligned with the long-term interests of our shareholders. These policies and procedures are described in detail on pages 12 to 15 of this Proxy Statement.

The ARRA provides that all participants in the TARP permit a non-binding shareholder vote to approve the compensation of the participant's executives. Therefore, the Board of Directors is providing our shareholders with the right to cast an advisory vote on the compensation of the Company's NEOs at the 2010 Annual Meeting of Shareholders.

This proposal, commonly known as a "say-on-pay" proposal, gives you as a shareholder the opportunity to vote on the compensation of our NEOs through the following resolution:

"RESOLVED, that the shareholders of Peoples Bancorp of North Carolina, Inc. approve the compensation of its Named Executive Officers named in the Summary Compensation Table in this Proxy Statement, as described in the narrative and the tabular disclosure regarding the compensation of the Named Executive Officers contained in this Proxy Statement."

Under the ARRA, your vote on this matter is advisory and will therefore not be binding upon the Board of Directors. However, the Compensation Committee will take the outcome of the vote into account when determining further executive compensation arrangements.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE APPROVAL OF THIS PROPOSAL.

PROPOSAL 3

RATIFICATION OF SELECTION OF INDEPENDENT AUDITOR

Porter Keadle Moore, LLP, of Atlanta, Georgia ("PKM"), has been selected by the Audit Committee as the Company's and the Bank's independent auditor for the year ending December 31, 2010. Such selection is being submitted to the Company's shareholders for ratification. Representatives of PKM are expected to attend the Meeting and will be afforded an opportunity to make a statement, if they so desire, and to respond to appropriate questions from shareholders.

Audit Fees

The aggregate fees billed by PKM for professional services rendered in connection with the (i) audit of the Company's annual financial statements for 2009 and 2008; (ii) review of the financial statements included in the Company's quarterly filings on Form 10-Q during those fiscal years; and (iii) review of the Company's internal controls over financial reporting in 2009 and 2008 were approximately $186,000 and $166,000, respectively.

Audit Related Fees

The aggregate fees billed by PKM in 2009 and 2008 for professional services rendered for assurance and related services that are reasonably related to the performance of the audit or review of the Company's financial statements and not included in "Audit Fees" above were approximately $20,000 and $18,000, respectively. These fees were primarily related to the audit of the Company's Profit Sharing and 401(k) Plan and the testing of management's assertions regarding internal controls in accordance with the Federal Deposit Insurance Corporation Improvement Act.

Tax Fees

The aggregate fees billed in each of the last two fiscal years for professional services rendered by PKM for tax compliance, tax advice, and tax planning were approximately $24,000 and $27,000 in 2009 and 2008, respectively. These fees were primarily related to the preparation of the Company's income tax returns, assistance with quarterly income tax estimates and preparation of Forms 5500 for various benefit plans.

All Other Fees

In addition to the fees outlined above, PKM billed fees in the amount of approximately $1,300 in 2009 and $5,000 in 2008. The 2008 fees primarily related to input on and review of documents associated with the TARP application.

The fees billed by PKM are pre-approved by the Audit Committee of the Company in accordance with the policies and procedures for the Audit Committee set forth in the Committee's charter. The Audit Committee typically pre-approves all audit and non-audit services provided by the Company's independent auditors and may not engage the independent auditors to perform any prohibited non-audit services. For 2009, 99% of the total fees paid for audit, audit related and tax services were pre-approved. For 2008, 98% of the total fees paid for audit, audit related and tax services were pre-approved. The Audit Committee has determined that the rendering of non-audit professional services by PKM, as identified above, is compatible with maintaining PKM's independence.

THE BOARD OF DIRECTORS RECOMMENDS THAT THE SHAREHOLDERS VOTE FOR RATIFICATION OF THE APPOINTMENT OF PKM AS INDEPENDENT AUDITOR FOR THE COMPANY AND THE BANK FOR THE FISCAL YEAR ENDING DECEMBER 31, 2010.

DATE FOR RECEIPT OF SHAREHOLDER PROPOSALS

It is presently anticipated that the 2011 Annual Meeting of Shareholders of the Company will be held on May 5, 2011. In order for shareholder proposals to be included in the Company's proxy materials for that meeting, such proposals must be received by the Secretary of the Company at the Company's principal executive office no later than December 3, 2010 and meet all other applicable requirements for inclusion in the Proxy Statement.

In the alternative, a shareholder may commence his or her own proxy solicitation and present a proposal from the floor at the 2011 Annual Meeting of Shareholders of the Company. In order to do so, the shareholder must notify the Secretary of the Company in writing, at the Company's principal executive office no later than February 16, 2011, of his or her proposal. If the Secretary of the Company is not notified of the shareholder's proposal by February 16, 2011, the Board of Directors may vote on the proposal pursuant to the discretionary authority granted by the proxies solicited by the Board of Directors for the 2011 Annual Meeting.

OTHER MATTERS

Management knows of no other matters to be presented for consideration at the Meeting or any adjournments thereof. If any other matters shall properly come before the Meeting, it is intended that the proxyholders named in the enclosed form of proxy will vote the shares represented thereby in accordance with their judgment, pursuant to the discretionary authority granted therein.

MISCELLANEOUS

The Annual Report of the Company for the year ended December 31, 2009, which includes financial statements audited and reported upon by the Company's independent auditor, is being mailed as Appendix A to this Proxy Statement; however, it is not intended that the Annual Report be deemed a part of this Proxy Statement or a solicitation of proxies.

THE FORM 10-K FILED BY THE COMPANY WITH THE SEC, INCLUDING THE FINANCIAL STATEMENTS AND SCHEDULES THERETO, WILL BE PROVIDED FREE OF CHARGE UPON WRITTEN REQUEST DIRECTED TO: PEOPLES BANCORP OF NORTH CAROLINA, INC., POST OFFICE BOX 467, 518 WEST C STREET, NEWTON, NORTH CAROLINA 28658-0467, ATTENTION: A. JOSEPH LAMPRON.

By Order of the Board of
Directors,

/s/ Tony W. Wolfe
Tony W. Wolfe
President and Chief
Executive Officer

Newton, North Carolina
March 29, 2010

EXHIBIT (13)

Appendix A to the Proxy Statement for the 2010 Annual Meeting of Shareholders

APPENDIX A

PEOPLES BANCORP OF NORTH CAROLINA, INC.

General Description of Business

Peoples Bancorp of North Carolina, Inc. (the "Company"), was formed in 1999 to serve as the holding company for Peoples Bank (the "Bank"). The Company is a bank holding company registered with the Board of Governors of the Federal Reserve System (the "Federal Reserve") under the Bank Holding Company Act of 1956, as amended (the "BHCA"). The Company's principal source of income is any dividends which are declared and paid by the Bank on its capital stock. The Company has no operations and conducts no business of its own other than owning the Bank. Accordingly, the discussion of the business which follows concerns the business conducted by the Bank, unless otherwise indicated.

The Bank, founded in 1912, is a state-chartered commercial bank serving the citizens and business interests of the Catawba Valley and surrounding communities through 22 banking offices located in Lincolnton, Newton, Denver, Catawba, Conover, Maiden, Claremont, Hiddenite, Hickory, Charlotte, Monroe, Cornelius, Mooresville and Raleigh North Carolina. The Bank also operates a loan production office in Denver, North Carolina. At December 31, 2009, the Company had total assets of $1.0 billion, net loans of $762.6 million, deposits of $809.3 million, total securities of $201.5 million, and shareholders' equity of $99.2 million.

The Bank has a diversified loan portfolio, with no foreign loans and few agricultural loans. Real estate loans are predominately variable rate commercial property loans, which include residential development loans to commercial customers. Commercial loans are spread throughout a variety of industries with no one particular industry or group of related industries accounting for a significant portion of the commercial loan portfolio. The majority of the Bank's deposit and loan customers are individuals and small to medium-sized businesses located in the Bank's market area. The Bank's loan portfolio also includes Individual Taxpayer Identification Number (ITIN) mortgage loans generated thorough the Bank's Banco de le Gente offices. Additional discussion of the Bank's loan portfolio and sources of funds for loans can be found in "Management's Discussion and Analysis of Financial Condition and Results of Operations" on pages A-4 through A-31 of the Annual Report, which is included in this Form 10-K as Exhibit 13.

The operations of the Bank and depository institutions in general are significantly influenced by general economic conditions and by related monetary and fiscal policies of depository institution regulatory agencies, including the Federal Reserve, the Federal Deposit Insurance Corporation (the "FDIC") and the North Carolina Commissioner of Banks (the "Commissioner").

At December 31, 2009, the Bank employed 267 full-time equivalent employees.

Subsidiaries

The Bank is a subsidiary of the Company. The Bank has two subsidiaries, Peoples Investment Services, Inc. and Real Estate Advisory Services, Inc. Through a relationship with Raymond James Financial Services, Inc., Peoples Investment Services, Inc. provides the Bank's customers access to investment counseling and non-deposit investment products such as stocks, bonds, mutual funds, tax deferred annuities, and related brokerage services. Real Estate Advisory Services, Inc. provides real estate appraisal and real estate brokerage services.

In June 2006, the Company formed a wholly owned Delaware statutory trust, PEBK Capital Trust II ("PEBK Trust II"), which issued $20.0 million of guaranteed preferred beneficial interests in the Company's junior subordinated deferrable interest debentures. All of the common securities of PEBK Trust II are owned by the Company. The proceeds from the issuance of the common securities and the trust preferred securities were used by PEBK Trust II to purchase $20.6 million of junior subordinated debentures of the Company, which pay a floating rate equal to three month LIBOR plus 163 basis points. The proceeds received by the Company from the sale of the junior subordinated debentures were used in December 2006 to repay the trust preferred securities issued by PEBK Trust in December 2001 and for general purposes. The debentures represent the sole asset of PEBK Trust II. PEBK Trust II is not included in the consolidated financial statements.

The trust preferred securities issued by PEBK Trust II accrue and pay quarterly at a floating rate of three-month LIBOR plus 163 basis points. The Company has guaranteed distributions and other payments due on the trust preferred securities to the extent PEBK Trust II does not have funds with which to make the distributions and other payments. The net combined effect of the trust preferred securities transaction is that the Company is obligated to make the distributions and other payments required on the trust preferred securities.

These trust preferred securities are mandatorily redeemable upon maturity of the debentures on June 28, 2036, or upon earlier redemption as provided in the indenture. The Company has the right to redeem the debentures purchased by PEBK Trust II, in whole or in part, on or after June 28, 2011. As specified in the indenture, if the debentures are redeemed prior to maturity, the redemption price will be the principal amount and any accrued but unpaid interest.

The Company established a new subsidiary, Community Bank Real Estate Solutions, LLC ("CBRES"), during second quarter 2009. CBRES serves as a "clearing-house" for appraisal services for community banks. Other banks are able to contract with CBRES to find and engage appropriate appraisal companies in the area where the property is located. This type of service ensures that the appraisal process remains independent from the financing process within the bank.

This report contains certain forward-looking statements with respect to the financial condition, results of operations and business of Peoples Bancorp of North Carolina, Inc. (the "Company"). These forward-looking statements involve risks and uncertainties and are based on the beliefs and assumptions of management of the Company and on the information available to management at the time that these disclosures were prepared. These statements can be identified by the use of words like "expect," "anticipate," "estimate" and "believe," variations of these words and other simila expressions. Readers should not place undue reliance on forward-looking statements as a number of important factors could cause actual results to differ materially from those in the forward-looking statements. Factors that could cause actual results to differ materially include, but are not limited to, (1) competition in the markets served by Peoples Bank (the "Bank"), (2) changes in the interest rate environment, (3) general national, regional or local economic conditions may be less favorable than expected, resulting in, among other things, a deterioration in credit quality and the possible impairment of collectibility of loans, (4) legislative or regulatory changes, including changes in accounting standards, (5) significant changes in the federal and state legal and regulatory environment and tax laws, (6) the impact of changes in monetary and fiscal policies, laws, rules and regulations and (7) other risks and factors identified in the Company's other filings with the Securities and Exchange Commission. The Company undertakes no obligation to update any forward-looking statements.

SELECTED FINANCIAL DATA
Dollars in Thousands Except Per Share Amounts

		2009	2008	2007	2006	2005
Summary of Operations						
Interest income	$	50,037	56,322	61,732	55,393	41,913
Interest expense		17,187	23,526	27,585	23,110	15,429
Net interest earnings		32,850	32,796	34,147	32,283	26,484
Provision for loan losses		10,535	4,794	2,038	2,513	3,110
Net interest earnings after provision for loan losses		22,315	28,002	32,109	29,770	23,374
Non-interest income		11,823	10,495	8,816	7,554	6,668
Non-interest expense		29,883	28,893	25,993	22,983	20,330
Earnings before taxes		4,255	9,604	14,932	14,341	9,712
Income taxes		1,339	3,213	5,340	5,170	3,381
Net earnings		2,916	6,391	9,592	9,171	6,331
Dividends and accretion of preferred stock		1,246	-	-	-	-
Net earnings available to common shareholders	$	1,670	6,391	9,592	9,171	6,331
Selected Year-End Balances						
Assets	$	1,048,494	968,762	907,262	818,948	730,280
Available for sale securities		195,115	124,916	120,968	117,581	115,158
Loans, net		762,643	770,163	713,174	643,078	559,239
Mortgage loans held for sale		2,840	-	-	-	2,248
Interest-earning assets		988,017	921,101	853,878	780,082	692,835
Deposits		809,343	721,062	693,639	633,820	582,854
Interest-bearing liabilities		826,838	758,334	718,870	650,364	576,681
Shareholders' equity	$	99,223	101,128	70,102	62,835	54,353
Shares outstanding*		5,539,056	5,539,056	5,624,234	5,745,951	5,677,328
Selected Average Balances						
Assets	$	1,016,257	929,799	846,836	772,585	706,843
Available for sale securities		161,135	115,853	120,296	118,137	108,690
Loans		782,464	747,203	665,379	604,427	550,545
Interest-earning assets		956,680	876,425	801,094	732,244	668,614
Deposits		772,075	720,918	659,174	605,407	570,997
Interest-bearing liabilities		796,260	740,478	665,727	613,686	563,210
Shareholders' equity	$	101,162	76,241	70,586	62,465	55,989
Shares outstanding*		5,539,056	5,588,314	5,700,860	5,701,829	5,692,290
Profitability Ratios						
Return on average total assets		0.29%	0.69%	1.13%	1.19%	0.90%
Return on average shareholders' equity		2.88%	8.38%	13.59%	14.68%	11.31%

Dividend payout ratio**		86.22%	41.93%	24.30%	20.78%	22.34%
Liquidity and Capital Ratios (averages)						
Loan to deposit		101.35%	103.65%	100.94%	99.84%	96.42%
Shareholders' equity to total assets		9.95%	8.20%	8.34%	8.09%	7.92%
Per share of Common Stock*						
Basic net income	$	0.30	1.14	1.68	1.61	1.11
Diluted net income	$	0.30	1.13	1.65	1.58	1.09
Cash dividends	$	0.26	0.48	0.41	0.33	0.25
Book value	$	13.37	13.73	12.46	10.94	9.57

*Shares outstanding and per share computations have been retroactively restated to reflect a 10% stock dividend during first quarter 2005, a 10% stock dividend during second quarter 2006 and a 3-for-2 stock split during second quarter 2007.

**As a percentage of net earnings available to common shareholders.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion of our financial position and results of operations and should be read in conjunction with the information set forth under Item 1A Risk Factors and the Company's consolidated financial statements and notes thereto on pages A-32 through A-66.

Introduction

Management's discussion and analysis of earnings and related data are presented to assist in understanding the consolidated financial condition and results of operations of the Company, for the years ended December 31, 2009, 2008 and 2007. The Company is a registered bank holding company operating under the supervision of the Federal Reserve Board and the parent company of Peoples Bank (the "Bank"). The Bank is a North Carolina-chartered bank, with offices in Catawba, Lincoln, Alexander, Mecklenburg, Iredell, Union and Wake counties, operating under the banking laws of North Carolina and the rules and regulations of the Federal Deposit Insurance Corporation (the "FDIC").

Overview

Our business consists principally of attracting deposits from the general public and investing these funds in commercial loans, real estate mortgage loans, real estate construction loans and consumer loans. Our profitability depends primarily on our net interest income, which is the difference between the income we receive on our loan and investment securities portfolios and our cost of funds, which consists of interest paid on deposits and borrowed funds. Net interest income also is affected by the relative amounts of interest-earning assets and interest-bearing liabilities. When interest-earning assets approximate or exceed interest-bearing liabilities, a positive interest rate spread will generate net interest income. Our profitability is also affected by the level of other income and operating expenses. Other income consists primarily of miscellaneous fees related to our loans and deposits, mortgage banking income and commissions from sales of annuities and mutual funds. Operating expenses consist of compensation and benefits, occupancy related expenses, federal deposit and other insurance premiums, data processing, advertising and other expenses.

Our operations are influenced significantly by local economic conditions and by policies of financial institution regulatory authorities. The earnings on our assets are influenced by the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System (the "Federal Reserve"), inflation, interest rates, market and monetary fluctuations. Lending activities are affected by the demand for commercial and other types of loans, which in turn is affected by the interest rates at which such financing may be offered. Our cost of funds is influenced by interest rates on competing investments and by rates offered on similar investments by competing financial institutions in our market area, as well as general market interest rates. These factors can cause fluctuations in our net interest income and other income. In addition, local economic conditions can impact the credit risk of our loan portfolio, in that (1) local employers may be required to eliminate employment positions of individual borrowers, and small businesses and (2) commercial borrowers may experience a downturn in their operating performance and become unable to make timely payments on their loans. Management evaluates these factors in estimating its allowance for loan losses and changes in these economic factors could result in increases or decreases to the provision for loan losses.

Economic conditions in 2009 continued to deteriorate and had a negative impact on our financial condition and results of operations. Unfavorable trends, such as increased unemployment, falling real estate prices, increased loan default and increased bankruptcy rates, demonstrate the difficult business conditions that are affecting the general economy and therefore our operating results. The unemployment rates in our primary market area have been higher than state and national averages throughout 2009.

Although we are unable to control the external factors that influence our business, by maintaining high levels of balance sheet liquidity, managing our interest rate exposures and by actively monitoring asset quality, we seek to minimize the potentially adverse risks of unforeseen and unfavorable economic trends.

Our business emphasis has been to operate as a well-capitalized, profitable and independent community-oriented financial institution dedicated to providing quality customer service. We are committed to meeting the financial needs of the communities in which we operate. We believe that we can be more effective in serving our customers than many of our non-local competitors because of our ability to quickly and effectively provide senior management responses to customer needs and inquiries. Our ability to provide these services is enhanced by the stability of our senior management team.

The Federal Reserve has decreased the Federal Funds Rate 4.00% since December 31, 2007 with the rate set at 0.25% as of December 31, 2009. These decreases had a negative impact on 2009 earnings and will continue to have a negative impact on the Bank's net interest income in the future periods. The negative impact from the decrease in the

Federal Funds Rate has been partially offset by the increase in earnings realized on interest rate contracts, including both an interest rate swap and interest rate floors, utilized by the Company. Additional information regarding the Company's interest rate contacts is provided below in the section entitled "Asset Liability and Interest Rate Risk Management."

On December 23, 2008, the Company entered into a Securities Purchase Agreement ("Purchase Agreement") with the United States Department of the Treasury ("UST"). Under the Purchase Agreement, the Company agreed to issue and sell 25,054 shares of Series A preferred stock and warrants to purchase 357,234 shares of common stock associated with the Company's participation in the U.S. Treasury Department's Capital Purchase Program ("CPP") under the Troubled Asset Relief Program ("TARP"). Proceeds from this issuance of preferred shares were allocated between preferred stock and the warrant based on their relative fair values at the time of the sale. Of the $25.1 million in proceeds, $24.4 million was allocated to the Series A preferred stock and $704,000 was allocated to the common stock warrant. The discount recorded on the preferred stock that resulted from allocating a portion of the proceeds to the warrant is being accreted directly to retained earnings over a five-year period applying a level yield. As of December 31, 2009, the Company has accreted a total of $126,000 of the discount related to the Series A preferred stock. The Company paid dividends of $1.1 million on the Series A preferred stock during 2009 and cumulative undeclared dividends at December 31, 2009 were $157,000. The CPP, created by the UST, is a voluntary program in which selected, healthy financial institutions were encouraged to participate. Approved use of the funds includes providing credit to qualified borrowers, either as companies or individuals, among other things. Such participation is intended to support the economic development of the community and thereby restore the health of the local and national economy.

The Series A preferred stock qualifies as Tier 1 capital and will pay cumulative dividends at a rate of 5% per annum for the first five years and 9% per annum thereafter. The Series A preferred stock may be redeemed at the stated amount of $1,000 per share plus any accrued and unpaid dividends. Under the terms of the original Purchase Agreement, the Company could not redeem the preferred shares until December 23, 2011 unless the total amount of the issuance, $25.1 million, was replaced with the same amount of other forms of capital that would qualify as Tier 1 capital. However, with the enactment of the American Recovery and Reinvestment Act of 2009 ("ARRA"), the Company can now redeem the preferred shares at any time, if approved by the Company's primary regulator. The Series A preferred stock is non-voting except for class voting rights on matters that would adversely affect the rights of the holders of the Series A preferred stock.

The exercise price of the warrant is $10.52 per common share and it is exercisable at anytime on or before December 18, 2018.

The Company is subject to the following restrictions while the Series A preferred stock is outstanding: 1) UST approval is required for the Company to repurchase shares of outstanding common stock; 2) the full dividend for the latest completed CPP dividend period must be declared and paid in full before dividends may be paid to common shareholders; 3) UST approval is required for any increase in common dividends per share above the last quarterly dividend of $0.12 per share paid prior to December 23, 2008; and 4) the Company may not take tax deductions for any senior executive officer whose compensation is above $500,000. There were additional restrictions on executive compensation added in the ARRA for companies participating in the TARP, including participants in the CPP.

It is the intent of the Company to utilize CPP funds to provide capital to support making loans to qualified borrowers in the Bank's market area. The funds will also be used to absorb losses incurred when modifying loans or making concessions to borrowers in order to keep borrowers out of foreclosure. The Bank is also working with its current builders and contractors to provide financing for potential buyers who may not be able to qualify for financing in the current mortgage market in order to help these customers sell existing single family homes. The Company will also use the CPP capital infusion as additional Tier I capital to protect the Bank from potential losses that may be incurred during this current recessionary period.

The Company continues to face challenges resulting from the impact of the current economy on the housing and real estate markets. The Bank continues to monitor and evaluate all significant loans in its portfolio, and will continue to manage its credit risk exposure with the expectation that stabilization of the real estate market will not occur until late 2010 or 2011. The CPP funds have enhanced our capital position as the Company infused the Bank with $8.0 million additional regulatory capital. The Company has $19.0 million available that can be infused into the Bank as additional capital if needed to maintain its position as a well capitalized bank. We anticipate increased loan losses in the short run and have prepared for that expectation. We have quality individuals managing our past due loans and foreclosed properties to minimize our potential losses. As the economy recovers, we are positioned to take advantage of all opportunities that present themselves. Over the remainder of the year we anticipate net interest margin improvement as repricing of deposits should exceed repricing of loans. The amount and timing of any future Federal Reserve rate adjustment remains uncertain, and may further impact the Bank if those adjustments are significant.

The Company established a new subsidiary, Community Bank Real Estate Solutions, LLC ("CBRES"), during second quarter 2009. CBRES will serve as a "clearing-house" for appraisal services for community banks. Other banks are able to contract with CBRES to find and engage appropriate appraisal companies in the area where the property is located. This type of service ensures that the appraisal process remains independent from the financing process within the bank.

The Bank opened a new office in Iredell County, in Mooresville, North Carolina in September 2009. Management continues to look for branching opportunities in nearby markets although there are no additional offices planned in 2010.

Summary of Significant Accounting Policies
The consolidated financial statements include the financial statements of Peoples Bancorp of North Carolina, Inc. and its wholly owned subsidiaries, Peoples Bank and Real Estate Solutions, along with the Bank's wholly owned subsidiaries, Peoples Investment Services, Inc. and Real Estate Advisory Services, Inc (collectively called the "Company"). All significant intercompany balances and transactions have been eliminated in consolidation.

The Company's accounting policies are fundamental to understanding management's discussion and analysis of results of operations and financial condition. Many of the Company's accounting policies require significant judgment regarding valuation of assets and liabilities and/or significant interpretation of specific accounting guidance. The following is a summary of some of the more subjective and complex accounting policies of the Company. A more complete description of the Company's significant accounting policies can be found in Note 1 of the Notes to Consolidated Financial Statements in the Company's 2009 Annual Report to Shareholders which is Appendix A to the Proxy Statement for the May 6, 2010 Annual Meeting of Shareholders.

Many of the Company's assets and liabilities are recorded using various techniques that require significant judgment as to recoverability. The collectability of loans is reflected through the Company's estimate of the allowance for loan losses. The Company performs periodic and systematic detailed reviews of its lending portfolio to assess overall collectability. In addition, certain assets and liabilities are reflected at their estimated fair value in the consolidated financial statements. Such amounts are based on either quoted market prices or estimated values derived from dealer quotes used by the Company, market comparisons or internally generated modeling techniques. The Company's internal models generally involve present value of cash flow techniques. The various techniques are discussed in greater detail elsewhere in management's discussion and analysis and the notes to consolidated financial statements.

There are other complex accounting standards that require the Company to employ significant judgment in interpreting and applying certain of the principles prescribed by those standards. These judgments include, but are not limited to, the determination of whether a financial instrument or other contract meets the definition of a derivative in accordance with Generally Accepted Accounting Principles ("GAAP"). For a more complete discussion of policies, see the notes to consolidated financial statements.

The disclosure requirements for derivatives and hedging activities have the intent to provide users of financial statements with an enhanced understanding of: (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. The disclosure requirements include qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about the fair value of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative instruments.

The Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Company may enter into derivative contracts that are intended to economically hedge certain of its risks, even though hedge accounting does not apply or the Company elects not to apply hedge accounting.

The Company has an overall interest rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. By using derivative instruments, the Company is exposed to credit and market risk. If the counterparty fails to perform, credit risk is equal to the extent of the fair-value gain in the derivative. The Company minimizes the credit risk in derivative instruments by entering into transactions with high-quality counterparties that are reviewed periodically by the Company. As of December 31, 2009, the Company had cash flow hedges with a notional amount of $50.0 million. This derivative instrument consists of one interest rate swap contract.

The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the Balance Sheet as of December 31, 2009 and December 31, 2008.

(Dollars in thousands)

	Asset Derivatives			
	As of December 31, 2009		As of December 31, 2008	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Interest rate derivative contracts	Other assets	$ 1,762	Other assets	$ 4,981

The Company's objectives in using interest rate derivatives are to add stability to interest income and expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps and floors as part of its interest rate risk management strategy. For hedges of the Company's variable-rate loan assets, interest rate swaps designated as cash flow hedges involve the receipt of fixed-rate amounts from a counterparty in exchange for the Company making variable-rate payments over the life of the agreements without exchange of the underlying notional amount. For hedges of the Company's variable-rate loan assets, the interest rate floor designated as a cash flow hedge involves the receipt of variable-rate amounts from a counterparty if interest rates fall below the strike rate on the contract in exchange for an up front premium. As of December 31, 2009, the Company had one interest rate swap with a notional amount of $50.0 million that was designated as a cash flow hedge of interest rate risk.

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in Accumulated Other Comprehensive Income and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. During 2009, such derivatives were used to hedge the variable cash inflows associated with existing pools of prime-based loan assets. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. The Company recognized a hedge ineffectiveness gain of $1,000 in earnings during the year ended December 31, 2009.

Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest income or expense as interest payments are received/made on the Company's variable-rate assets/liabilities. During the next twelve months, the Company estimates that $1.4 million will be reclassified as an increase to interest income.

The tables below present the effect of the Company's derivative financial instruments on the Income Statement for the years ended December 31, 2009 and 2008.

(Dollars in thousands)

	Amount of Gain (Loss) Recognized in OCI on Derivatives	Location of Gain (Loss) Reclassified	Amount of Gain (Loss) Reclassified from Accumulated OCI into Income

	Years ended December 31, 2009	2008	from Accumulated OCI into Income	Years ended December 31, 2009	2008
Interest rate derivative contracts	$ 434	$ 7,147	Interest income	$ 3,114	$ 3,403
			Non-interest income	$ 46	$ -

Relating to the post retirement benefit plan, the Company is required to recognize an obligation for either the present value of the entire promised death benefit or the annual "cost of insurance" required to keep the policy in force during the post-retirement years. The Company made a $467,000 reduction to retained earnings in 2008 pursuant to the guidance of the pronouncement to record the portion of this benefit earned by participants prior to adoption of the pronouncement. In 2009 the Company made a $358,000 addition to retained earnings to reflect an adjustment of the cumulative effect due to amendments to the individual split-dollar plans implemented during 2009.

GAAP establishes a framework for measuring fair value and expands disclosures about fair value measurements. There is a three-level fair value hierarchy for fair value measurements. Level 1 inputs are quoted prices in active markets for identical assets or liabilities that a company has the ability to access at the measurement date. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for the asset or liability. The table below presents the balance of securities available for sale and derivatives, which are measured at fair value on a recurring basis by level within the fair value hierarchy as of December 31, 2009 and 2008.

(Dollars in thousands)

	Fair Value Measurements December 31, 2009	Level 1 Valuation	Level 2 Valuation	Level 3 Valuation
Investment securities available for sale	$ 195,115	861	193,004	1,250
Mortgage loans held for sale	$ 2,840	-	2,840	-
Market value of derivatives (in other assets)	$ 1,762	-	1,762	-

	Fair Value Measurements December 31, 2008	Level 1 Valuation	Level 2 Valuation	Level 3 Valuation
Investment securities available for sale	$ 124,916	935	122,731	1,250
Market value of derivatives (in other assets)	$ 4,981	-	4,981	-

Fair values of investment securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges when available. If quoted prices are not available, fair value is determined using matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities. Fair values of derivative instruments are determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities.

The following is an analysis of fair value measurements of investment securities available for sale using Level 3, significant unobservable inputs, for the year ended December 31, 2009:

(Dollars in thousands)

	Investment Securities Available for Sale Level 3 Valuation
Balance, beginning of period	$ 1,250
Change in book value	-
Change in gain/(loss) realized and unrealized	-
Purchases/(sales)	-
Transfers in and/or out of Level 3	-

Balance, end of period	$	1,250
Change in unrealized gain/(loss) for assets still held in Level 3	$	-

The Company's December 31, 2009 and 2008 fair value measurement for impaired loans and other real estate on a non-recurring basis is presented below:

(Dollars in thousands)

		Fair Value Measurements December 31, 2009	Level 1 Valuation	Level 2 Valuation	Level 3 Valuation	Total Gains/(Losses) for the Year Ended December 31, 2009
Impaired loans	$	15,958	-	14,174	1,784	(1,924)
Other real estate	$	3,997	-	3,997	-	(100)

		Fair Value Measurements December 31, 2008	Level 1 Valuation	Level 2 Valuation	Level 3 Valuation	Total Gains/(Losses) for the Year Ended December 31, 2008
Impaired loans	$	7,073	-	5,903	1,170	(345)
Other real estate	$	1,867	-	1,867	-	(166)

The Company has specific loan loss reserves for loans that management has determined to be impaired. These specific reserves are determined on an individual loan basis based on management's current evaluation of the Company's loss exposure for each credit, given the expected cash flow or appraised value of any underlying collateral. At December 31, 2009 and 2008, the recorded investment in loans that were considered to be impaired was approximately $16.6 million and $7.5 million, respectively. In addition, the Company had approximately $2.0 million and $514,000 in loans past due more than ninety days and still accruing interest at December 31, 2009 and 2008, respectively. The Company had specific reserves on impaired loans of $673,000 and $462,000 at December 31, 2009 and 2008, respectively. The average recorded investment in impaired loans for the twelve months ended December 31, 2009 and 2008 was approximately $15.0 million and $8.8 million, respectively. For the years ended December 31, 2009, 2008 and 2007, the Company recognized approximately $53,000, $57,000 and $29,000, respectively, of interest income on impaired loans.

At each reporting period, the Company determines which loans are impaired. Accordingly, the Company's impaired loans are reported at their estimated fair value on a non-recurring basis. An allowance for each impaired loan, which are generally collateral-dependent, is calculated based on the fair value of its collateral. The fair value of the collateral is based on appraisals performed by third-party valuation specialists. Factors including the assumptions and techniques utilized by the appraiser are considered by Management. If the recorded investment in the impaired loan exceeds the measure of fair value of the collateral, a valuation allowance is recorded as a component of the allowance for loan losses.

In April 2009, the Financial Accounting Standards Board ("FASB") issued new authoritative guidance under the following two ASC's intended to provide additional guidance and enhance disclosures regarding fair value measurements and impairment of securities:

ASC Topic 820 (formerly FASB Staff Position (FSP) FAS 157-4), "Fair Value Measurements and Disclosures," provides additional guidance for estimating fair value in accordance with ASC Topic 820 when the volume and level of activity for the asset or liability have decreased significantly. ASC Topic 820 also provides guidance on identifying circumstances that indicate a transaction is not orderly. The provisions of ASC Topic 820 were effective for the period ended March 31, 2009 and did not have a significant effect on the Company's condensed consolidated financial statements.

ASC Topic 320 (formerly FSP FAS 115-2 and FAS 124-2), "Investments – Debt and Equity Securities," amends current other-than-temporary impairment guidance in GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This ASC Topic 320 does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. The Company adopted the provisions of ASC Topic 320 as of June 30, 2009 and it did not have a significant effect on the Company's condensed consolidated financial statements.

In June 2009, the FASB issued new authoritative guidance under ASC Topic 860 (formerly Statement No. 166) "Transfers and Servicing," to enhance reporting about transfers of financial assets, including securitizations, and where companies have continuing exposure to the risks related to transferred financial assets. ASC Topic 860 eliminates the concept of a "qualifying special-purpose entity" and changes the requirements for derecognizing financial assets. ASC Topic 860 also requires additional disclosures about all continuing involvements with transferred financial assets including information about gains and losses resulting from transfers during the period. The new authoritative guidance under ASC Topic 860 will be effective January 1, 2010 and is not expected to have a significant impact on the Company's consolidated financial statements.

In June 2009, the FASB issued SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)" (SFAS 167) to amend certain requirements of FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. SFAS 167 will remain authoritative until integrated into FASB Codification. SFAS 167 is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. SFAS 167 has not had any effect on the Company's financial position, results of operations or disclosures.

In June 2009, the FASB issued Accounting Standards Update No. 2009-01 ("ASU 2009-01"), "Topic 105 – Generally Accepted Accounting Principles amendments based on Statement of Financial Accounting Standards No. 168 – The FASB Accounting Standards Codification TM and the Hierarchy of Generally Accepted Accounting Principles." ASU 2009-01 amends the FASB Accounting Standards Codification for the issuance of FASB Statement No. 168 ("SFAS 168"), "The FASB Accounting Standards Codification TM and the Hierarchy of Generally Accepted Accounting Principles." ASU 2009-1 includes SFAS 168 in its entirety, including the accounting standards update instructions contained in Appendix B of the Statement. The FASB Accounting Standards Codification TM ("Codification") became the source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission ("SEC") under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date of this Statement, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other non-grandfathered non-SEC accounting literature not included in the Codification will become non-authoritative. This Statement was effective for the Company's financial statements beginning in the interim period ended September 30, 2009.

Following this Statement, the FASB will not issue new standards in the form of Statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates. The FASB does not consider Accounting Standards Updates as authoritative in their own right. Accounting Standards Updates serve only to update the Codification, provide background information about the guidance, and provide the basis for conclusions on the change(s) in the Codification. FASB Statement No. 162, "The Hierarchy of Generally Accepted Accounting Principles", which became effective on November 13, 2008, identified the sources of accounting principles and the framework for selecting the principles used in preparing the financial statements of nongovernmental entities that are presented in conformity with GAAP. Statement 162 arranged these sources of GAAP in a hierarchy for users to apply accordingly. Upon becoming effective, all of the content of the Codification carries the same level of authority, effectively superseding Statement 162. In other words, the GAAP hierarchy has been modified to include only two levels of GAAP: authoritative and non-authoritative. As a result, this Statement replaces Statement 162 to indicate this change to the GAAP hierarchy. The adoption of the Codification and ASU 2009-01 did not have any effect on the Company's results of operations or financial position. All references to accounting literature included in the notes to the financial statements have been changed to reference the appropriate sections of the Codification.

In June 2009, the FASB issued Accounting Standards Update No. 2009-02 ("ASU 2009-02"), "Omnibus Update – Amendments to Various Topics for Technical Corrections." The adoption of ASU 2009-02 did not have a material effect on the Company's results of operations, financial position or disclosures.

In August 2009, the FASB issued Accounting Standards Update No. 2009-05 ("ASU 2009-05"), "Fair Value Measurements and Disclosures (Topic 820) – Measuring Liabilities at Fair Value." ASU 2009-05 applies to all entities that measure liabilities at fair value within the scope of ASC Topic 820. ASU 2009-05 provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the following techniques:

1) A valuation technique that uses:
a. The quoted price of the identical liability when traded as an asset
b. Quoted prices for similar liabilities or similar liabilities when traded as assets.
2) Another valuation technique that is consistent with the principles of ASC Topic 820. Two examples would be an income approach, such as a technique that is based on the amount at the measurement date that the reporting entity would pay to transfer the identical liability or would receive to enter into the identical liability.

The amendments in ASU 2009-5 also clarify that when estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability. It also clarifies that both a quoted price in an active market for the identical liability at the measurement date and the quoted price for the identical liability when traded as an asset in an active market when no adjustments to the quoted price of the asset are required are Level 1 fair value measurements. The guidance provided in ASU 2009-5 became effective for the Company in the fourth quarter of 2009. Because the Company does not currently have any liabilities that are recorded at fair value, the adoption of this guidance did not have any impact on results of operations, financial position or disclosures.

ASU 2009-12, “Fair Value Measurements and Disclosures (Topic 820) - Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent),” issued in September, 2009, allows a company to measure the fair value of an investment that has no readily determinable fair market value on the basis of the investee's net asset value per share as provided by the investee. This allowance assumes that the investee has calculated net asset value in accordance with the GAAP measurement principles of Topic 946 as of the reporting entity's measurement date. Examples of such investments include investments in hedge funds, private equity funds, real estate funds and venture capital funds. The update also provides guidance on how the investment should be classified within the fair value hierarchy based on the value for which the investment can be redeemed. The amendment is effective for interim and annual periods ending after December 15, 2009 with early adoption permitted. The Company does not have investments in such entities and, therefore, there is no impact to our financial statements.

ASU 2009-13, “Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements – a consensus of the FASB Emerging Issues Task Force” was issued in October, 2009 and provides guidance on accounting for products or services (deliverables) separately rather than as a combined unit utilizing a selling price hierarchy to determine the selling price of a deliverable. The selling price is based on vendor-specific evidence, third-party evidence or estimated selling price. The amendments in the Update are effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010 with early adoption permitted. The Company does not expect the update to have an impact on its financial statements.

Issued October, 2009, ASU 2009-15, “Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing” amends ASC Topic 470 and provides guidance for accounting and reporting for own-share lending arrangements issued in contemplation of a convertible debt issuance. At the date of issuance, a share-lending arrangement entered into on an entity's own shares should be measured at fair value in accordance with Topic 820 and recognized as an issuance cost, with an offset to additional paid-in capital. Loaned shares are excluded from basic and diluted earnings per share unless default of the share-lending arrangement occurs. The amendments also require several disclosures including a description and the terms of the arrangement and the reason for entering into the arrangement. The effective dates of the amendments are dependent upon the date the share-lending arrangement was entered into and include retrospective application for arrangements outstanding as of the beginning of fiscal years beginning on or after December 15, 2009. The Company has no plans to issue convertible debt and, therefore, the update had no impact on its financial statements as of December 31, 2009.

In December 2009, the FASB issued Accounting Standards Update No. 2009-16 (“ASU 2009-16”), “Accounting for Transfers of Financial Assets”. ASU No. 2009-16 formally incorporates into the FASB Codification amendments to SFAS No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities”, made by SFAS No. 166 “Accounting for Transfers of Financial Assets”, an amendment of FASB Statement No. 140, primarily to 1.) eliminate the concept of a qualifying special-purpose entity, 2.) limit the circumstances under which a financial asset should be derecognized when the entire financial asset has not been transferred to a non-consolidated entity, 3.) requires additional disclosures concerning a transferor’s continuing involvement with transferred financial assets and 4.) requires that all servicing assets and liabilities be measured at fair value. This guidance is effective as of the start of the first annual and interim reporting periods. ASU No. 2009-19 is not expected to have a material impact on the Company’s results of operations, financial position or disclosures; however the Company will need to review future loan participation agreements and other transfers of financial assets for compliance with the new standard.

In December 2009, the FASB issued Accounting Standards Update No. 2009-17 ("ASU 2009-17"), "Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities". ASU No. 2009-17 formally incorporates into the FASB Codification amendments to FASB Interpretation ("FIN") No. 46(R), "Consolidation of Variable Interest Entities", made by SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)" to require that a comprehensive qualitative analysis be performed to determine whether a holder of variable interests in a variable interest entity also has a controlling financial interest in the entity. In addition, the amendments require that the same type of analysis be applied to entities that were previously designated as qualified special-purpose entities. This ASU is effective as of the start of the first annual reporting period beginning after November 15, 2009, for interim periods within the first annual reporting period and for all subsequent annual and interim reporting periods. ASU No. 2009-17 is not expected to have a material impact on the Company's financial position, results of operations or disclosures.

In January 2010, the FASB issued Accounting Standards Update No. 2010-06 (“ASU 2010-06”), “Improving Disclosures about Fair Value Measurements”. ASU No. 2010-06 amends FASB Accounting Standards Codification topic 820-10-50, “Fair Value Measurements and Disclosures”, to require additional information to be disclosed principally regarding Level 3 measurements and transfers to Level 1 and 2. In addition, enhanced disclosure is required concerning inputs and valuation techniques used to determine Level 2 and Level 3 measurements. This guidance is generally effective for interim and annual reporting periods beginning with December 15, 2009; however requirements to disclose separately purchases, sales, issuances and settlements in the Level 3 reconciliation are effective for fiscal years beginning after December 15, 2010 (and for interim periods within such years). ASU No. 2010-06 is not expected to have a material impact on the Company’s financial position or results of operations and will have a minimal impact on its disclosures.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

Management of the Company has made a number of estimates and assumptions relating to reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare the accompanying consolidated financial statements in conformity with GAAP. Actual results could differ from those estimates.

The remainder of management’s discussion and analysis of the Company’s results of operations and financial position should be read in conjunction with the consolidated financial statements and related notes presented on pages A-32 through A-66.

Results of Operations

Summary. The Company reported earnings of $2.9 million in 2009, or $0.53 basic and diluted net earnings per common share before adjustment for preferred stock dividends and accretion as compared to $6.4 million, or $1.14 basic net earnings per common share and $1.13 diluted net earnings per common share for 2008. After adjusting for $1.2 million in dividends and accretion on preferred stock, net earnings available to common shareholders for the year ended December 31, 2009 were $1.7 million or $0.30 basic and diluted net earnings per common share. Net earnings from recurring operations for the year ended December 31, 2009 were $2.5 million, or $0.46 basic and diluted net earnings per share, before adjustment for preferred stock dividends and accretion, as compared to net earnings from recurring operations of $6.7 million, or $1.20 basic net earnings per share and $1.19 diluted net earnings per share, for the same period one year ago. The Company’s decrease in net earnings for 2009 is primarily attributable to an increase in provision for loan losses and an increase in non-interest expense, which were partially offset by an increase in non-interest income.

Net earnings for 2008 represented a decrease of 33% as compared to 2007 net earnings of $9.6 million or $1.68 basic net earnings per common share and $1.65 diluted net earnings per common share. The decrease in 2008 net earnings was primarily attributable to a decrease in net interest income, an increase in the provision for loan losses and an increase in non-interest expense, which was partially offset by an increase in non-interest income.

The return on average assets in 2009 was 0.29%, compared to 0.69% in 2008 and 1.13% in 2007. The return on average shareholders’ equity was 2.88% in 2009 compared to 8.38% in 2008 and 13.59% in 2007.

Net Interest Income. Net interest income, the major component of the Company's net income, is the amount by which interest and fees generated by interest-earning assets exceed the total cost of funds used to carry them. Net interest income is affected by changes in the volume and mix of interest-earning assets and interest-bearing liabilities, as well as changes in the yields earned and rates paid. Net interest margin is calculated by dividing tax-equivalent net interest income by average interest-earning assets, and represents the Company’s net yield on its interest-earning assets.

Net interest income for 2009 increased to $32.9 million compared to $32.8 million in 2008. This increase is primarily attributable to a reduction in interest expense due to a decrease in the cost of funds for time deposits. Net interest income decreased 4% in 2008 from $34.1 million in 2007. The decrease in 2008 was primarily related to a reduction in the Bank's prime commercial lending rate. The decrease in loan interest income resulting from a decline in prime rate was partially offset by an increase in income from derivative instruments. Net income from derivative instruments was $3.4 million for the year ended December 31, 2008 compared to a net loss of $406,000 for the same period in 2007.

Table 1 sets forth for each category of interest-earning assets and interest-bearing liabilities, the average amounts outstanding, the interest incurred on such amounts and the average rate earned or incurred for the years ended December 31, 2009, 2008 and 2007. The table also sets forth the average rate earned on total interest-earning assets, the average rate paid on total interest-bearing liabilities, and the net yield on average total interest-earning assets for the same periods. Yield information does not give effect to changes in fair value that are reflected as a component of shareholders' equity. Yields and interest income on tax-exempt investments have been adjusted to tax equivalent basis using an effective tax rate of 38.55% for securities that are both federal and state tax exempt and an effective tax rate of 6.90% for state tax exempt securities. Non-accrual loans and the interest income that was recorded on these loans, if any, are included in the yield calculations for loans in all periods reported.

Table 1- Average Balance Table

	December 31, 2009			December 31, 2008			December 31, 2007		
(Dollars in thousands)	Average Balance	Interest	Yield / Rate	Average Balance	Interest	Yield / Rate	Average Balance	Interest	Yield / Rate
Interest-earning assets:									
Loans	$ 782,464	40,058	5.12%	747,203	46,808	6.26%	665,379	55,109	8.28%
Interest rate derivative contracts	-	3,114	0.40%	-	3,403	0.45%	-	(406)	-0.06%
Loan fees	-	39	0.00%	-	393	0.05%	-	698	0.10%
Total loans	782,464	43,211	5.52%	747,203	50,604	6.77%	665,379	55,401	8.33%
Investments - taxable	81,642	3,477	4.26%	26,591	1,253	4.71%	20,305	868	4.27%
Investments - nontaxable*	79,493	4,226	5.32%	89,262	4,924	5.52%	99,991	5,470	5.47%
Federal funds sold	704	1	0.14%	3,050	55	1.80%	7,378	383	5.19%
Other	12,377	53	0.43%	10,319	293	2.84%	8,041	444	5.52%
Total interest-earning assets	956,680	50,968	5.33%	876,425	57,129	6.52%	801,094	62,566	7.81%
Cash and due from banks	31,225			21,331			20,081		
Other assets	41,866			41,626			34,287		
Allowance for loan losses	(13,514)			(9,583)			(8,626)		
Total assets	$ 1,016,257			929,799			846,836		
Interest-bearing liabilities:									
NOW accounts	$ 112,452	1,373	1.22%	92,612	1,269	1.37%	79,550	1,127	1.42%
Regular savings accounts	35,762	368	1.03%	17,423	50	0.29%	18,685	54	0.29%
Money market accounts	94,537	1,224	1.29%	93,564	1,930	2.06%	87,916	2,918	3.32%
Time deposits	412,127	9,687	2.35%	406,127	15,008	3.70%	361,859	17,430	4.82%
FHLB / FRB borrowings	84,547	3,596	4.25%	79,417	3,616	4.55%	80,058	3,759	4.70%

Demand notes payable to U.S. Treasury	805	-	0.00%	859	14	1.63%	814	39	4.79%
Trust preferred securities	20,619	546	2.65%	20,619	1,016	4.93%	20,619	1,476	7.16%
Other	35,411	393	1.11%	29,857	624	2.09%	16,226	782	4.82%
Total interest-bearing liabilities	796,260	17,187	2.16%	740,478	23,527	3.18%	665,727	27,585	4.14%
Demand deposits	117,197			111,192			111,164		
Other liabilities	2,428			4,021			3,022		
Shareholders' equity	101,162			76,241			70,586		