

FIRST BANCORP /NC/  
Form 10-K  
March 14, 2016

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

**FORM 10-K**

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2015

Commission File Number 0-15572

**FIRST BANCORP**

(Exact Name of Registrant as Specified in its Charter)

North Carolina 56-1421916  
(State of Incorporation) (I.R.S. Employer Identification Number)

300 SW Broad Street, Southern Pines, North Carolina 28387  
(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code: (910) 246-2500

Securities Registered Pursuant to Section 12(b) of the Act:

| <u>Title of each class</u> | <u>Name of each exchange on which registered</u> |
|----------------------------|--|
| Common Stock, No Par Value | The Nasdaq Global Select Market                  |

Securities Registered Pursuant to Section 12(g) of the Act: None

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933.  YES  NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934.  YES  NO

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  YES  NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  YES  NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of the Form 10-K or any amendment to the Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one)

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer  Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  YES  NO

The aggregate market value of the Common Stock, no par value, held by non-affiliates of the registrant, based on the closing price of the Common Stock as of June 30, 2015 as reported by The NASDAQ Global Select Market, was approximately \$311,995,897.

The number of shares of the registrant's Common Stock outstanding on February 29, 2016 was 19,750,969.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement to be filed pursuant to Regulation 14A are incorporated herein by reference into Part III.

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Information called for by Part III (Items 10 through 14) is incorporated herein by reference to the Registrant's \*definitive Proxy Statement for the 2016 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission on or before April 29, 2016.

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**FORWARD-LOOKING STATEMENTS**

This report contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 and the Private Securities Litigation Reform Act of 1995, which statements are inherently subject to risks and uncertainties. Forward-looking statements are statements that include projections, predictions, expectations or beliefs about future events or results or otherwise are not statements of historical fact. Further, forward-looking statements are intended to speak only as of the date made. Such statements are often characterized by the use of qualifying words (and their derivatives) such as “expect,” “believe,” “estimate,” “plan,” “project,” or other statements concerning our opinions or judgment about future events. Our actual results may differ materially from those anticipated in any forward-looking statements, as they will depend on many factors about which we are unsure, including many factors which are beyond our control. Factors that could influence the accuracy of such forward-looking statements include, but are not limited to, the financial success or changing strategies of our customers, our level of success in integrating acquisitions, actions of government regulators, the level of market interest rates, and general economic conditions. For additional information about factors that could affect the matters discussed in this paragraph, see the “Risk Factors” section in Item 1A of this report.

**PART I**

**Item 1. Business**

**General Description**

First Bancorp (the “Company”) is a bank holding company. Our principal activity is the ownership and operation of First Bank (the “Bank”), a state-chartered bank with its main office in Southern Pines, North Carolina. The Company is also the parent to a series of statutory business trusts organized under the laws of the State of Delaware that were created for the purpose of issuing trust preferred debt securities. Our outstanding debt associated with these trusts was \$46.4 million at December 31, 2015 and 2014.

The Company was incorporated in North Carolina on December 8, 1983, as Montgomery Bancorp, for the purpose of acquiring 100% of the outstanding common stock of the Bank through a stock-for-stock exchange. On December 31, 1986, the Company changed its name to First Bancorp to conform its name to the name of the Bank, which had changed its name from Bank of Montgomery to First Bank in 1985.

The Bank was organized in 1934 and began banking operations in 1935 as the Bank of Montgomery, named for the county in which it operated. Until September 2013, the Bank's main office was in Troy, North Carolina, located in the center of Montgomery County. In September 2013, the Company and the Bank moved their main offices approximately 45 miles to Southern Pines, North Carolina, in Moore County. As of December 31, 2015, we conducted business from 88 branches covering a geographical area from Florence, South Carolina to the southeast, to Wilmington, North Carolina to the east, to Kill Devil Hills, North Carolina to the northeast, to Salem, Virginia to the north, to Abingdon, Virginia to the northwest, and to Asheville, North Carolina to the west. We also have loan production offices in Greenville, North Carolina and Charlotte, North Carolina. Of the Bank's 88 branches, 75 branches are in North Carolina, six branches are in South Carolina and seven branches are in Virginia (where we operate under the name "First Bank of Virginia"). Ranked by assets, the Bank was the sixth largest bank headquartered in North Carolina as of December 31, 2015.

As of December 31, 2015, the Bank had two wholly owned subsidiaries, First Bank Insurance Services, Inc. ("First Bank Insurance") and First Troy SPE, LLC. First Bank Insurance's primary business activity is the placement of property and casualty insurance coverage. First Troy SPE, LLC, which was organized in December 2009, is a holding entity for certain foreclosed properties.



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Our principal executive offices are located at 300 SW Broad Street, Southern Pines, North Carolina, 28387, and our telephone number is (910) 246-2500. Unless the context requires otherwise, references to the “Company,” “we,” “our,” or “us” in this annual report on Form 10-K shall mean collectively First Bancorp and its consolidated subsidiaries.

## **General Business**

We engage in a full range of banking activities, with the acceptance of deposits and the making of loans being our most basic activities. We offer deposit products such as checking, savings, and money market accounts, as well as time deposits, including various types of certificates of deposits (CDs) and individual retirement accounts (IRAs). We provide loans for a wide range of consumer and commercial purposes, including loans for business, agriculture, real estate, personal uses, home improvement and automobiles. We also offer credit cards, debit cards, letters of credit, safe deposit box rentals and electronic funds transfer services, including wire transfers. In addition, we offer internet banking, mobile banking, cash management and bank-by-phone capabilities to our customers, and are affiliated with ATM networks that give our customers access to 67,000 ATMs, with no surcharge fee. We also offer a mobile check deposit feature for our mobile banking customers that allows them to securely deposit checks via their smartphone. For our business customers, we offer remote deposit capture, which provides them with a method to electronically transmit checks received from customers into their bank account without having to visit a branch. We are a member of the Certificate of Deposit Account Registry Service (CDARS), which gives our customers the ability to obtain FDIC insurance on deposits of up to \$50 million, while continuing to work directly with their local First Bank branch.

Because the majority of our customers are individuals and small to medium-sized businesses located in the counties we serve, management does not believe that the loss of a single customer or group of customers would have a material adverse impact on the Bank. There are no seasonal factors that tend to have any material effect on the Bank’s business, and we do not rely on foreign sources of funds or income. Because we operate primarily within North Carolina, southwestern Virginia and northeastern South Carolina, the economic conditions of these areas could have a material impact on the Company. See additional discussion below in the section entitled “Territory Served and Competition.”

Beginning in 1999, First Bank Insurance began offering non-FDIC insured investment and insurance products, including mutual funds, annuities, long-term care insurance, life insurance, and company retirement plans, as well as financial planning services (the “investments division”). In May 2001, First Bank Insurance added to its product line when it acquired two insurance agencies that specialized in the placement of property and casualty insurance. In October 2003, the “investments division” of First Bank Insurance became a part of the Bank and the primary activity of First Bank Insurance became the placement of property and casualty insurance products. On January 1, 2016, First Bank Insurance acquired Bankingport, Inc., an insurance agency based in Sanford, North Carolina, which provides First Bank Insurance with economies of scale and a larger platform for leveraging insurance services throughout the First Bank branch network.

First Bancorp Capital Trust II and First Bancorp Capital Trust III were organized in December 2003 for the purpose of issuing \$20.6 million in debt securities (\$10.3 million was issued from each trust). These borrowings are due on

January 23, 2034 and are also structured as trust preferred capital securities in order to qualify as regulatory capital. These debt securities are callable by the Company at par on any quarterly interest payment date beginning on January 23, 2009. The interest rate on these debt securities adjusts on a quarterly basis at a weighted average rate of three-month LIBOR plus 2.70%.

First Bancorp Capital Trust IV was organized in April 2006 for the purpose of issuing \$25.8 million in debt securities. These borrowings are due on June 15, 2036 and are also structured as trust preferred capital

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securities that qualify as regulatory capital. These debt securities are callable by the Company at par on any quarterly interest payment date beginning on June 15, 2011. The interest rate on these debt securities adjusts on a quarterly basis at a rate of three-month LIBOR plus 1.39%.

**Territory Served and Competition**

Our headquarters are located in Southern Pines, Moore County, North Carolina, where we also have our highest concentration of deposits. At the end of 2015, we served primarily the south central region (sometimes called the Piedmont region), the central mountain region and the eastern coastal region of North Carolina, with additional operations in northeastern South Carolina and southwestern Virginia. The following table presents, for each county where we operated as of December 31, 2015, the number of bank branches operated by the Company within the county, the approximate amount of deposits with the Company in the county as of December 31, 2015, our approximate deposit market share at June 30, 2015, and the number of bank competitors located in the county at June 30, 2015.

| County           | Number of Branches | Deposits (in millions) | Market Share | Number of Competitors |
|------------------|--------------------|------------------------|--------------|-----------------------|
| Anson, NC        | 1                  | \$ 13                  | 5.3 %        | 4                     |
| Beaufort, NC     | 2                  | 46                     | 4.8 %        | 7                     |
| Bladen, NC       | 1                  | 26                     | 9.4 %        | 5                     |
| Brunswick, NC    | 4                  | 113                    | 6.6 %        | 11                    |
| Buncombe, NC     | 3                  | 86                     | 1.8 %        | 16                    |
| Cabarrus, NC     | 2                  | 38                     | 1.9 %        | 11                    |
| Carteret, NC     | 2                  | 36                     | 3.2 %        | 8                     |
| Chatham, NC      | 2                  | 64                     | 9.6 %        | 10                    |
| Chesterfield, SC | 1                  | 43                     | 12.4 %       | 6                     |
| Columbus, NC     | 2                  | 38                     | 5.0 %        | 5                     |
| Cumberland, NC   | 1                  | 4                      | 0.0 %        | 14                    |
| Dare, NC         | 1                  | 20                     | 2.0 %        | 9                     |
| Davidson, NC     | 2                  | 88                     | 3.2 %        | 10                    |
| Dillon, SC       | 3                  | 67                     | 24.3 %       | 3                     |
| Duplin, NC       | 3                  | 132                    | 16.7 %       | 6                     |
| Florence, SC     | 2                  | 38                     | 1.6 %        | 12                    |
| Guilford, NC     | 1                  | 70                     | 0.7 %        | 20                    |
| Harnett, NC      | 3                  | 106                    | 11.8 %       | 9                     |
| Iredell, NC      | 2                  | 33                     | 1.3 %        | 20                    |
| Lee, NC          | 3                  | 161                    | 22.5 %       | 9                     |
| Montgomery, NC   | 4                  | 118                    | 39.2 %       | 2                     |
| Montgomery, VA   | 3                  | 66                     | 3.9 %        | 13                    |
| Moore, NC        | 10                 | 462                    | 25.5 %       | 10                    |
| New Hanover, NC  | 5                  | 143                    | 2.9 %        | 18                    |
| Onslow, NC       | 2                  | 45                     | 3.9 %        | 10                    |

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|                              |    |          |       |    |
|------------------------------|----|----------|-------|----|
| Randolph, NC                 | 3  | 74       | 4.8 % | 12 |
| Richmond, NC                 | 2  | 42       | 10.8% | 5  |
| Roanoke, VA                  | 1  | 5        | 0.4 % | 12 |
| Robeson, NC                  | 4  | 182      | 19.1% | 9  |
| Rockingham, NC               | 1  | 25       | 2.7 % | 10 |
| Rowan, NC                    | 1  | 69       | 4.4 % | 13 |
| Scotland, NC                 | 2  | 69       | 21.1% | 6  |
| Stanly, NC                   | 4  | 96       | 10.5% | 6  |
| Wake, NC                     | 2  | 32       | 0.1 % | 30 |
| Washington, VA               | 1  | 19       | 1.7 % | 16 |
| Wythe, VA                    | 2  | 66       | 11.5% | 11 |
| Brokered & Internet Deposits | -  | 76       |       |    |
| Total                        | 88 | \$ 2,811 |       |    |

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Our branches and facilities are primarily located in small communities whose economies are based primarily on services, manufacturing and light industry. Although our market is predominantly small communities and rural areas, the market area is not dependent on agriculture. Textiles, furniture, mobile homes, electronics, plastic and metal fabrication, forest products, food products, and chicken hatcheries are among the leading manufacturing industries in the trade area. Leading producers of lumber and rugs are located in Montgomery County, North Carolina. The Pinehurst area within Moore County, North Carolina, is a widely known golf resort and retirement area. The High Point, North Carolina, area is widely known for its furniture market. New Hanover and Brunswick Counties, located in the southeastern coastal region of North Carolina, are popular with tourists and have significant retirement populations. Buncombe County, located in the western region of North Carolina, is a highly diverse area with industries in manufacturing, service, and tourism. Additionally, several of the communities served by the Company are “bedroom” communities of large cities like Charlotte, Raleigh and Greensboro, while several branches are located in medium-sized cities such as Albemarle, Asheboro, Fayetteville, Jacksonville, High Point, Southern Pines and Sanford. We also have branches in small communities such as Bennett, Polkton, Vass, and Harmony.

In addition to the branches shown above, in the second half of 2013, we established a loan production office in Greenville, North Carolina, and in the second half of 2015, we established a loan production office in Charlotte, North Carolina. In early 2016, in connection with the hiring of five bankers from a local community bank competitor, we established loan production offices in Greensboro and Raleigh, North Carolina. These are new, yet contiguous, markets to our branch footprint, and are consistent with our recent branch expansion strategy of focusing on larger, higher growth markets.

In March 2016, we announced we had reached an agreement to exchange our seven bank branches located in Virginia for six North Carolina bank branches of a community bank that is headquartered in Virginia, with a similar amount of loans and deposits. Four of the six branches we expect to assume are in Winston-Salem, with the other two branches being in the Charlotte-metro markets of Mooresville and Huntersville. According to the agreement, it is expected that substantially all deposits and certain loans assigned to the branches will transfer. Currently, our branches in Virginia have approximately \$150 million in deposits, while the branches we expect to assume have approximately \$130 million in deposits. It is estimated that the amount of loans that will be transferred between the two banks will be up to \$175 million. We entered Virginia in 2001 with a branch in Wytheville and had grown that presence to a total of seven branches. The distant proximity to our core market and the opportunity to assume what is essentially a banking franchise in markets where we have recently invested in human capital were the primary factors we considered in entering into the exchange agreement.

Approximately 16% of our deposit base is in Moore County. Accordingly, material changes in competition, the economy or population of Moore County could materially impact the Company. No other county comprises more than 10% of our deposit base.

We compete in our various market areas with, among others, several large interstate bank holding companies. These large competitors have substantially greater resources than our Company, including broader geographic markets, higher lending limits and the ability to make greater use of large-scale advertising and promotions. A significant number of interstate banking acquisitions have taken place in the past decade, thus further increasing the size and

financial resources of some of our competitors, some of which are among the largest bank holding companies in the nation. In many of our markets, we also compete against smaller, local banks. With interest rates on investment securities at historic lows and banks of all sizes attempting to maximize yields on earning assets, the competition for high-quality loans has become intense. Accordingly, loan rates in our markets are under competitive pressure. The pricing competition for deposits has lessened, but at any given time in many of our markets, there are frequently smaller banks offering higher rates on deposits than we are willing to match. This has resulted in our bank losing the deposits of some price-sensitive customers, which has been primarily responsible for the declines in our time deposit accounts that are discussed below in Management's Discussion and Analysis of Financial Condition and Results of Operation. Moore County, which as noted above comprises a disproportionate share of our deposits, is a particularly competitive market, with at least ten other financial institutions having a physical presence within the county.

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We compete not only against banking organizations, but also against a wide range of financial service providers, including federally and state-chartered savings and loan institutions, credit unions, investment and brokerage firms and small-loan or consumer finance companies. One of the credit unions in our market area is among the largest in the nation. Competition among financial institutions of all types is virtually unlimited with respect to legal ability and authority to provide most financial services. We also experience competition from internet banks, particularly in the area of time deposits.

Despite the competitive market, we believe we have certain advantages over our competition in the areas we serve. We are large enough to be able to more easily absorb higher costs being experienced in the banking industry, particularly regulatory costs and technology costs, than the smaller banks we compete with. We are also able to originate significantly larger loans than many of our smaller bank competitors. At the same time, we attempt to maintain a banking culture associated with smaller banks – a culture that has a personal and local flavor that appeals to many retail and small business customers. Specifically, we seek to maintain a distinct local identity in each of the communities we serve and we actively sponsor and participate in local civic affairs. Most lending and other customer-related business decisions can be made without the delays often associated with larger institutions. Additionally, employment of local managers and personnel in various offices and low turnover of personnel enable us to establish and maintain long-term relationships with individual and corporate customers.

## **Lending Policy and Procedures**

Conservative lending policies and procedures and appropriate underwriting standards are high priorities of the Bank. Loans are approved under our written loan policy, which provides that lending officers, principally branch managers, have authority to approve loans of various amounts up to \$350,000 with lending limits varying depending upon the experience of the lending officer and whether the loan is secured or unsecured. We have seven senior lending officers that have authority to approve secured loans up to \$500,000 and each of our three Regional Presidents has authority to approve secured loans up to \$1,000,000. Loans up to \$3,000,000 are approved by the Bank's Regional Credit Officers through our Credit Administration Department. The Bank's Chief Credit Officer has authority to approve loans up to \$6,000,000, while the Chief Credit Officer and the Bank's President have joint authority to approve loans up to \$8,000,000. The Bank's board of directors maintains loan authority up to the Bank's in-house limit of \$25,000,000 and generally approves loans through its Executive Loan Committee. All lending authorities are based on the borrower's Total Credit Exposure ("TCE"), which is an aggregate of the Bank's lending relationship to the borrower. TCE is based on the borrower's total credit exposure with the Bank either directly or indirectly through loan guarantees or other borrowing entities related to the borrower through control or ownership.

The Executive Loan Committee reviews and approves loans that exceed management's lending authority, loans to executive officers, directors, and their affiliates and, in certain instances, other types of loans. New credit extensions are reviewed daily by our senior management and the Credit Administration Department.

We continually monitor our loan portfolio to identify areas of concern and to enable us to take corrective action. Lending and credit administration officers and the board of directors meet periodically to review past due loans and portfolio quality, while assuring that the Bank is appropriately meeting the credit needs of the communities it serves. Individual lending officers are responsible for monitoring any changes in the financial status of borrowers and pursuing collection of early-stage past due amounts. For certain types of loans that exceed our established parameters of past due status, the Bank's Asset Resolution Group assumes the management of the loan, and in some cases we engage a third-party firm to assist in collection efforts.



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The Bank has an internal Loan Review Department that conducts on-going and targeted reviews of the Bank's loan portfolio and assesses the Bank's adherence to loan policies, risk grading and accrual policies. Reports are generated for management based on these activities and findings are used to adjust risk grades as deemed appropriate. In addition, these reports are shared with the Company's board of directors. The Loan Review Department also provides training assistance to the Bank's Training and Credit Administration departments.

To further assess the Bank's loan portfolio and as a secondary review of the Bank's Loan Review Department, we also contract with an independent consulting firm to review new loan originations meeting certain criteria, as well as to assign risk grades to existing credits meeting certain thresholds. The consulting firm's observations, comments, and risk grades, including variances with the Bank's risk grades, are shared with the audit committee of the Company's board of directors and are considered by management in setting Bank policy, as well as in evaluating the adequacy of our allowance for loan losses. For additional information, see "Allowance for Loan Losses and Loan Loss Experience" under Item 7 below.

## **Investment Policy and Procedures**

We have adopted an investment policy designed to maximize our income from funds not needed to meet loan demand, in a manner consistent with appropriate liquidity and risk objectives. Pursuant to this policy, we may invest in federal, state and municipal obligations, federal agency obligations, public housing authority bonds, industrial development revenue bonds, Federal Home Loan Bank bonds, Fannie Mae bonds, Government National Mortgage Association bonds, Freddie Mac bonds, Small Business Administration bonds, and, to a limited extent, corporate bonds. We may also invest up to \$60 million in time deposits with other financial institutions. Time deposit purchases from any one financial institution exceeding FDIC insurance coverage limits are evaluated as a corporate bond and are subject to the same due diligence requirements as corporate bonds (described below).

In making investment decisions, we do not solely rely on credit ratings to determine the credit-worthiness of an issuer of securities, but we use credit ratings in conjunction with other information when performing due diligence prior to the purchase of a security. Securities that are not rated investment grade will not be purchased. Securities rated below Moody's BAA or Standard and Poor's BBB generally will not be purchased. Securities rated below A are periodically reviewed for credit-worthiness. We may purchase non-rated municipal bonds only if such bonds are in our general market area and we determine these bonds have a credit risk no greater than the minimum ratings referred to above. Industrial development authority bonds, which normally are not rated, are purchased only if they are judged to possess a high degree of credit soundness to assure reasonably prompt sale at a fair value. We are also authorized by our board of directors to invest a portion of our securities portfolio in high quality corporate bonds, with the amount of such bonds not to exceed 15% of the entire securities portfolio. Prior to purchasing a corporate bond, the Company's management performs due diligence on the issuer of the bond, and the purchase is not made unless we believe that the purchase of the bond bears no more risk to the Company than would an unsecured loan to the same company.

Our Chief Investment Officer implements the investment policy, monitors the investment portfolio, recommends portfolio strategies and reports to the Company's Investment Committee. The Investment Committee generally meets on a quarterly basis to review investment activity and to assess the overall position of the securities portfolio. The Investment Committee compares our securities portfolio with portfolios of other companies of comparable size. In addition, reports of all purchases, sales, issuer calls, net profits or losses and market appreciation or depreciation of the securities portfolio are reviewed by our board of directors. Once a quarter, our interest rate risk exposure is evaluated by our board of directors. Each year, the written investment policy is approved by the board of directors.

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**Mergers and Acquisitions**

As part of our operations, we have pursued an acquisition strategy over the years to augment our internal growth. We regularly evaluate the potential acquisition of, or merger with, various financial institutions. Our acquisitions have generally fallen into one of three categories - 1) an acquisition of a financial institution or branch thereof within a market in which we operate, 2) an acquisition of a financial institution or branch thereof in a market contiguous or nearly contiguous to a market in which we operate, or 3) an acquisition of a company that has products or services that we do not currently offer. Historically, we have paid for our acquisitions with cash and/or common stock and any operating income or loss has been fully borne by the Company beginning on the closing date of the acquisition.

In 2009, FDIC-assisted acquisitions began to occur frequently as banking regulators closed problem banks. In FDIC-assisted transactions, the acquiring bank often does not pay any consideration for the failed bank, and in some cases receives cash from the FDIC as part of the transaction. In addition, the acquiring bank usually enters into one or more loss share agreements with the FDIC, which affords the acquiring bank significant loss protection. As discussed below, we completed FDIC-assisted transactions in 2009 and 2011.

We believe that we can enhance our earnings by pursuing these types of acquisition opportunities through any combination or all of the following: 1) achieving cost efficiencies, 2) enhancing the acquiree's earnings or gaining new customers by introducing a more successful banking model with more products and services to the acquiree's market base, 3) increasing customer satisfaction or gaining new customers by providing more locations for the convenience of customers, and 4) leveraging the customer base by offering new products and services. There is also the possibility, especially in a FDIC-assisted transaction, to record a gain on the acquisition date arising from the difference between the purchase price and the acquisition date fair value of the acquired assets and liabilities.

Since becoming a public company in 1987, we have completed numerous acquisitions in each of the three categories described above. We have completed several whole-bank traditional acquisitions in our existing and contiguous markets; we have purchased numerous bank branches from other banks (both in existing market areas and in contiguous/nearly contiguous markets) and we have acquired several insurance agencies, which has provided us with the ability to offer property and casualty insurance coverage.

In addition to the traditional acquisitions discussed above, in both 2009 and 2011 we acquired the operations of failed banks in FDIC-assisted transactions. On June 19, 2009, we acquired substantially all of the assets and liabilities of Cooperative Bank in a FDIC-assisted transaction. Cooperative Bank operated through twenty-one branches in North Carolina and three branches in South Carolina in the same markets in which the Bank was already operating, as well as in several new, mostly contiguous markets. In connection with the acquisition, the Bank assumed assets with a book value of \$959 million, including \$829 million in loans and \$706 million in deposits. See the Company's 2009 Annual Report on Form 10-K for more information on this acquisition.

On January 21, 2011, we acquired substantially all of the assets and liabilities of The Bank of Asheville in a FDIC-assisted transaction. The Bank of Asheville operated through five branches in or near Asheville, North Carolina. This market was a new market for the Bank. In connection with the acquisition, the Bank assumed assets with a book value of \$190 million, including \$154 million in loans and \$192 million in deposits. See the Company's 2011 Annual Report on Form 10-K for more information on this acquisition.

The following paragraphs describe the other acquisitions that we have completed in the past three years.

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On March 22, 2013, we completed the purchase of two branches from Four Oaks Bank & Trust Company located in Southern Pines and Rockingham, North Carolina. We acquired \$57 million in deposits and \$16 million in loans in the acquisition. We purchased the Rockingham branch building, but did not purchase the Southern Pines branch building and instead transferred the acquired accounts to one of the Company's nearby existing branches.

In January 2016, we acquired Bankingport, Inc., an insurance agency based in Sanford, North Carolina. Although not material to the Company's consolidated operations, the acquisition provided us with the opportunity to enhance our product offerings, as well as expand our insurance agency operations into a significant banking market for our Company. Also this acquisition provides us a larger platform for leveraging insurance services throughout our bank branch network.

As noted previously, in March 2016, we announced we had reached an agreement to exchange our seven bank branches located in Virginia for six North Carolina bank branches of a community bank that is headquartered in Virginia, with a similar amount of loans and deposits. Four of the six branches we expect to assume are in Winston-Salem, with the other two branches being in the Charlotte-metro markets of Mooresville and Huntersville. According to the agreement, it is expected that substantially all deposits and certain loans assigned to the branches will transfer. Currently, our branches in Virginia have approximately \$150 million in deposits, while the branches we expect to assume have approximately \$130 million in deposits. It is estimated that the amount of loans that will be transferred between the two banks will be up to \$175 million. We entered Virginia in 2001 with a branch in Wytheville and had grown that presence to a total of seven branches. The distant proximity to our core market and the opportunity to assume what is essentially a banking franchise in markets where we have recently invested in human capital were the primary factors we considered in entering into the exchange agreement.

There are many factors that we consider when evaluating how much to offer for potential acquisition candidates (including FDIC-assisted transactions) with a few of the more significant factors being projected impact on earnings per share, projected impact on capital, and projected impact on book value and tangible book value. Significant assumptions that affect this analysis include the estimated future earnings stream of the acquisition candidate, estimated credit and other losses to be incurred, the amount of cost efficiencies that can be realized, and the interest rate earned/lost on the cash received/paid. In addition to these primary factors, we also consider other factors including (but not limited to) marketplace acquisition statistics, location of the candidate in relation to our expansion strategy, market growth potential, management of the candidate, potential integration issues (including corporate culture), and the size of the acquisition candidate.

We plan to continue to evaluate acquisition opportunities that could potentially benefit the Company and its shareholders. These opportunities may include acquisitions that do not fit the categories discussed above.

For a further discussion of recent acquisition activity, see "Merger and Acquisition Activity" under Item 7 below.

## **Employees**

As of December 31, 2015, we had 783 full-time and 57 part-time employees. We are not a party to any collective bargaining agreements, and we consider our employee relations to be good.

## **Supervision and Regulation**

As a bank holding company, we are subject to supervision, examination and regulation by the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”) and the North Carolina Office of the Commissioner of Banks (the “Commissioner”). The Bank is subject to supervision and examination by the Federal Reserve Board (“FRB”) and the Commissioner. Until April 22, 2015, the Bank was regulated by the Federal Deposit Insurance Corporation (“FDIC”). Effective April 22, 2015, the Bank became a member of the Federal Reserve System, and therefore, the FRB replaced the FDIC as the Bank’s primary federal regulator. For additional information, see Note 16 to the consolidated financial statements.

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**Supervision and Regulation of the Company**

The Company is a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended. The Company is also regulated by the Commissioner under the North Carolina Bank Holding Company Act of 1984.

A bank holding company is required to file quarterly reports and other information regarding its business operations and those of its subsidiaries with the Federal Reserve Board (“FRB”). It is also subject to examination by the FRB and is required to obtain FRB approval prior to making certain acquisitions of other institutions or voting securities. The FRB requires the Company to maintain certain levels of capital - see “Capital Resources and Shareholders’ Equity” under Item 7 below. The FRB also has the authority to take enforcement action against any bank holding company that commits any unsafe or unsound practice, or violates certain laws, regulations or conditions imposed in writing by the FRB. The FRB generally prohibits a bank holding company from declaring or paying a cash dividend that would impose undue pressure on the capital of subsidiary banks or would be funded only through borrowing or other arrangements which might adversely affect a bank holding company’s financial position. Under the FRB policy, a bank holding company is not permitted to continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each dividend and its prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition.

The Commissioner is empowered to regulate certain acquisitions of North Carolina banks and bank holding companies, issue cease and desist orders for violations of North Carolina banking laws, and promulgate rules necessary to effectuate the purposes of the North Carolina Bank Holding Company Act of 1984.

Regulatory authorities have cease and desist powers over bank holding companies and their nonbank subsidiaries where their actions would constitute a serious threat to the safety, soundness or stability of a subsidiary bank. Those authorities may compel holding companies to invest additional capital into banking subsidiaries upon acquisitions or in the event of significant loan losses or rapid growth of loans or deposits.

The United States Congress and the North Carolina General Assembly have periodically considered and adopted legislation that has impacted the Company.

**Supervision and Regulation of the Bank**

Federal banking regulations applicable to all depository financial institutions, among other things: (i) provide federal bank regulatory agencies with powers to prevent unsafe and unsound banking practices; (ii) restrict preferential loans

by banks to “insiders” of banks; (iii) require banks to keep information on loans to major shareholders and executive officers and (iv) bar certain director and officer interlocks between financial institutions.

As a state-chartered bank, the Bank is subject to the provisions of the North Carolina banking statutes and to regulation by the Commissioner. The Commissioner has a wide range of regulatory authority over the activities and operations of the Bank, and the Commissioner’s staff conducts periodic examinations of the Bank and its affiliates to ensure compliance with state banking regulations and to assess the safety and soundness of the Bank. Among other things, the Commissioner regulates the merger and consolidation of state-chartered banks, the payment of dividends, loans to officers and directors, recordkeeping, types and amounts of loans and investments, and the establishment of branches. The Commissioner also has cease and desist powers over state-chartered banks for violations of state banking laws or regulations and for unsafe or unsound conduct that is likely to jeopardize the interest of depositors.



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The dividends that may be paid by the Bank to the Company are subject to legal limitations under North Carolina law. In addition, under FRB regulations, a dividend cannot be paid by the Bank if it would be less than well-capitalized after the dividend. The FRB may also prevent the payment of a dividend by the Bank if it determines that the payment would be an unsafe and unsound banking practice. The ability of the Company to pay dividends to its shareholders is largely dependent on the dividends paid to the Company by the Bank.

The FRB is authorized to approve conversions, mergers, consolidations and assumptions of deposit liability transactions between insured banks and uninsured banks or institutions, and to prevent capital or surplus diminution in such transactions if the resulting, continuing, or assumed bank is an insured member bank. The FRB also conducts periodic examinations of the Bank to assess its safety and soundness and its compliance with banking laws and regulations, and it has the power to implement changes to, or restrictions on, the Bank's operations if it finds that a violation is occurring or is threatened. In addition, the FRB monitors the Bank's compliance with several banking statutes, such as the Depository Institution Management Interlocks Act and the Community Reinvestment Act of 1977.

## **Small Business Lending Fund**

In December 2010, the U.S. Treasury announced the creation of the Small Business Lending Fund (SBLF) program, which was established under the Small Business Jobs Act of 2010. The SBLF was created to encourage lending to small businesses by providing capital to qualified community banks at favorable rates.

Interested financial institutions were required to submit an application and a small business lending plan. Less than half of the financial institutions that applied for the SBLF were approved. We were one of the institutions approved, and on September 1, 2011, we completed the sale of \$63.5 million of Series B Preferred Stock to the Treasury under the SBLF ("SBLF stock"). Under the terms of the stock purchase agreement, the Treasury received 63,500 shares of Series B non-cumulative perpetual preferred stock with a liquidation value of \$1,000 per share, in exchange for \$63.5 million. The initial dividend rate on SBLF stock was 5%. The terms of the stock provided that our dividend rate could decrease to as low as 1% for a period of time depending on our success in meeting certain loan growth targets to small businesses. Based on our increases in small business lending, we achieved the minimal dividend rate of 1% as of March 31, 2013. The increase in the amount of small business loans remained at a level corresponding to a 1% dividend rate at September 30, 2013, at which point the terms of the preferred stock provided that the dividend rate remained fixed until March 1, 2016. On March 1, 2016, the contractual dividend rate was set to increase to 9%. The Company redeemed \$32 million of the SBLF stock in June 2015 and the remaining \$31.5 million in October 2015, which ended our participation in the SBLF. See Note 19 to the consolidated financial statements for more information.

## **FDIC Insurance**

As a member of the FDIC, the Bank's deposits are insured by the FDIC up to a maximum amount, which is currently \$250,000 per depositor. For this protection, each member bank pays a quarterly statutory assessment (which is based on average total assets less average tangible equity) and is subject to the rules and regulations of the FDIC.

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We recognized approximately \$2.4 million, \$4.0 million, and \$2.8 million in FDIC insurance expense in 2015, 2014, and 2013, respectively. FDIC insurance expense includes deposit insurance assessments and Financing Corporation (“FICO”) assessments related to outstanding FICO bonds.

## **Legislative and Regulatory Developments**

The most significant recent legislative and regulatory developments impacting the Company are 1) the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and 2) Basel III, which are discussed below.

### *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010*

On July 21, 2010, the Dodd-Frank Act became law. The Dodd-Frank Act has had and will continue to have a broad impact on the financial services industry, including significant regulatory and compliance changes including, among other things,

- enhanced authority over troubled and failing banks and their holding companies;
- increased capital and liquidity requirements;
- increased regulatory examination fees;
- specific provisions designed to improve supervision and safety and soundness by imposing restrictions and limitations on the scope and type of banking and financial activities.

In addition, the Dodd-Frank Act established a new framework for systemic risk oversight within the financial system that will be enforced by new and existing federal regulatory agencies, including the Financial Stability Oversight Council (FSOC), the FRB, the Office of Comptroller of the Currency, the FDIC, and the Consumer Financial Protection Bureau (CFPB). The following description briefly summarizes aspects of the Dodd-Frank Act that could impact the Company, both currently and prospectively.

*Deposit Insurance.* The Dodd-Frank Act made permanent the \$250,000 deposit insurance limit for insured deposits, which was an increase from the previous limit of \$100,000. Amendments to the Federal Deposit Insurance Act also revised the assessment base against which an insured depository institution’s deposit insurance premiums paid to the FDIC’s Deposit Insurance Fund (DIF) will be calculated. Under the amendments, which became effective on April 1, 2011, the FDIC assessment base is no longer the institution’s deposit base, but rather its average consolidated total assets less its average tangible equity. The Dodd-Frank Act also changed the minimum designated reserve ratio of the DIF, increasing the minimum from 1.15% to 1.35% of the estimated amount of total insured deposits, and eliminating the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds by September 30, 2020.

*Trust Preferred Securities.* The Dodd-Frank Act prohibits bank holding companies from including in their regulatory Tier I capital hybrid debt and equity securities issued on or after May 19, 2010. Among the hybrid debt and equity securities included in this prohibition are trust preferred securities, which we have issued in the past in order to raise additional Tier I capital and otherwise improve our regulatory capital ratios. Although we may continue to include our existing trust preferred securities as Tier I capital because they were issued prior to May 18, 2010, the prohibition on the use of these securities as Tier I capital may limit our ability to raise capital in the future.

*The Consumer Financial Protection Bureau.* The Dodd-Frank Act created a new, independent federal agency called the Consumer Financial Protection Bureau (CFPB), which is granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, the Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act and certain other statutes. The CFPB has examination and primary enforcement authority with respect to depository institutions with \$10 billion or more in assets. Depository institutions with less than \$10 billion in assets, such as the Bank, are subject to rules promulgated by the CFPB but will continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB will have authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products.

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The Dodd-Frank Act also authorized the CFPB to establish certain minimum standards for the origination of residential mortgages, including a determination of the borrower's ability to repay. Among other things, the rules adopted by the CFPB require banks to: (i) develop and implement procedures to ensure compliance with a "reasonable ability to repay" test and identify whether a loan meets a new definition for a "qualified mortgage," in which case a rebuttable presumption exists that the creditor extending the loan has satisfied the reasonable ability to repay test; (ii) implement new or revised disclosures, policies and procedures for originating and servicing mortgages including, but not limited to, pre-loan counseling, early intervention with delinquent borrowers and specific loss mitigation procedures for loans secured by a borrower's principal residence; (iii) comply with additional restrictions on mortgage loan originator hiring and compensation; (iv) comply with new disclosure requirements and standards for appraisals and certain financial products; and (v) maintain escrow accounts for higher-priced mortgage loans for a longer period of time. It is our policy not to make predatory loans and to determine borrowers' ability to repay, but the law and related rules create the potential for increased liability with respect to our lending and loan investment activities. They increase our cost of doing business and ultimately, may prevent us from making certain loans and cause us to reduce the average percentage rate or the points and fees on loans that we do make.

The Dodd-Frank Act also permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorney generals to enforce compliance with both the state and federal laws and regulations. Compliance with any such new regulations established by the CFPB and/or states could reduce our revenue, increase our cost of operations, and limit our ability to expand into certain products and services.

*Debit Card Interchange Fees.* The Dodd-Frank Act gave the FRB the authority to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers having assets over \$10 billion and to enforce a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer. Effective October 1, 2011, the FRB set new caps on interchange fees at \$0.21 per transaction, plus an additional five basis-point charge per transaction to help cover fraud losses. An additional \$0.01 per transaction is allowed if certain fraud-monitoring controls are in place. While we are not directly subject to these rules so long as our assets do not exceed \$10 billion, our activities as a debit card issuer may nevertheless be indirectly impacted by the change in the applicable debit card market caused by these regulations, which may require us to match any new lower fee structure implemented by larger financial institutions in order to remain competitive in the future. Nevertheless, to date, the Company has not noted any significant indirect negative effects of the interchange fee caps that are applicable to the larger financial institutions.

*Increased Capital Standards and Enhanced Supervision.* The Dodd-Frank Act required the federal banking agencies to establish minimum leverage and risk-based capital requirements for banks and bank holding companies. These new standards are to be no less strict than existing regulatory capital and leverage standards applicable to insured depository institutions and may, in fact, become higher once the agencies promulgate the new standards. Compliance with heightened capital standards may reduce our ability to generate or originate revenue-producing assets and thereby restrict revenue generation from banking and non-banking operations. See discussion of the new capital requirements established by the federal banking agencies under "Recent Amendments to Regulatory Capital Requirement under Basel III" below.



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*Transactions with Affiliates.* The Dodd-Frank Act enhances the requirements for certain transactions with affiliates under Section 23A and 23B of the Federal Reserve Act, including an expansion of the definition of “covered transactions,” and an increase in the amount of time for which collateral requirements regarding covered transactions must be maintained.

*Transactions with Insiders.* The Dodd-Frank Act expands insider transaction limitations through the strengthening of loan restrictions to insiders and the expansion of the types of transactions subject to the various limits, including derivative transactions, repurchase agreements, reverse repurchase agreements and securities lending and borrowing transactions. The Dodd-Frank Act also places restrictions on certain asset sales to and from an insider of an institution, including requirements that such sales be on market terms and, in certain circumstances, receive the approval of the institution’s board of directors.

*Enhanced Lending Limits.* The Dodd-Frank Act strengthens the existing limits on a depository institution’s credit exposure to one borrower. Federal banking law limits a national bank’s ability to extend credit to one person or group of related persons to an amount that does not exceed certain thresholds. The Dodd-Frank Act expands the scope of these restrictions to include credit exposure arising from derivative transactions, repurchase agreements and securities lending and borrowing transactions. It also will eventually prohibit state-chartered banks, including the Bank, from engaging in derivative transactions unless the state lending limit laws take into account credit exposure to such transactions.

*Corporate Governance.* The Dodd-Frank Act addresses many corporate governance and executive compensation matters that will affect most U.S. publicly traded companies, including the Company. The Dodd-Frank Act:

- grants shareholders of U.S. publicly traded companies an advisory vote on executive compensation;
- enhances independence requirements for compensation committee members;
- requires companies listed on national securities exchanges to adopt clawback policies for incentive-based compensation plans applicable to executive officers; and
- provides the SEC with authority to adopt proxy access rules that would allow shareholders of publicly traded companies to nominate candidates for election as directors and require such companies to include such nominees in its proxy materials.

*The Volcker Rule.* Section 619 of the Dodd-Frank Act, known as the “Volcker Rule,” prohibits any bank, bank holding company, or affiliate (referred to collectively as “banking entities”) from engaging in two types of activities: “proprietary trading” and the ownership or sponsorship of private equity or hedge funds that are referred to as “covered funds.” Proprietary trading is, in general, trading in securities on a short-term basis for a banking entity’s own account. Funds subject to the ownership and sponsorship prohibition are those not required to register with the Securities and Exchange Commission because they have only accredited investors or no more than 100 investors. In December 2013, our primary federal regulator, the FRB, together with other federal banking agencies, the FEDIC, the SEC and the Commodity Futures Trading Commission, finalized a regulation to implement the Volcker Rule. At December 31, 2015, the Company has evaluated our securities portfolio and has determined that we do not hold any covered funds.

Many of the requirements of the Dodd-Frank Act remain subject to implementation over the course of several years. While we do not currently expect the final requirements of the Dodd-Frank Act to have a material adverse impact on the Company, we do expect them to negatively impact our profitability, require changes to certain of our business practices, including limitations on fee income opportunities, and impose more stringent capital, liquidity and leverage requirements upon the Company. These changes may also require us to invest significant management attention and resources to evaluate and make any changes necessary to comply with the new statutory and regulatory requirements.



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Recent Amendments to Regulatory Capital Requirement under Basel III

In July 2013, the federal banking agencies approved amendments to their regulatory capital rules to conform U.S. regulatory capital rules with the international regulatory standards agreed to by the Basel Committee on Banking Supervision in the accord referred to as “Basel III.” The revisions establish new higher capital ratio requirements, narrow the definitions of capital, impose new operating restrictions on banking organizations with insufficient capital buffers and increase the risk weighting of certain assets. The new capital requirements apply to all banks, savings associations, bank holding companies with more than \$500 million in assets, such as the Company and the Bank, and all savings and loan holding companies regardless of asset size. The rules became effective for institutions with assets over \$250 billion and internationally active institutions in January 2014 and became effective for all other institutions in January 2015. The following discussion summarizes the changes we believe are most likely to affect the Company and the Bank.

*New and Increased Capital Requirements.* The regulations establish a new capital measure called “Common Equity Tier I Capital” consisting of common stock and related surplus, retained earnings, accumulated other comprehensive income and, subject to certain adjustments, minority common equity interests in subsidiaries. Unlike the current rules which exclude unrealized gains and losses on available-for-sale debt securities from regulatory capital, the amended rules generally require accumulated other comprehensive income to flow through to regulatory capital unless a one-time, irrevocable opt-out election is made in the first regulatory reporting period under the new rule. Depository institutions and their holding companies were required to maintain Common Equity Tier I Capital equal to 4.5% of risk-weighted assets starting in 2015.

The regulations also increase the required ratio of Tier I Capital to risk-weighted assets from 4% to 6% effective January 1, 2015. Tier I Capital consists of Common Equity Tier I Capital plus Additional Tier I Capital which includes non-cumulative perpetual preferred stock. Cumulative preferred stock (other than cumulative preferred stock issued to the U.S. Treasury under the TARP Capital Purchase Program or the Small Business Lending Fund) no longer qualifies as Additional Tier I Capital. Trust preferred securities and other non-qualifying capital instruments issued prior to May 19, 2010 by bank and savings and loan holding companies with less than \$15 billion in assets as of December 31, 2009, such as the Company, may continue to be included in Tier I Capital, but these instruments will be phased out over 10 years beginning in 2016 for all other banking organizations. These non-qualified capital instruments, however, may be included in Tier II Capital which could also include qualifying subordinated debt.

*Changes to Prompt Corrective Action Capital Categories.* The Prompt Corrective Action rules, effective January 1, 2015, incorporated the Common Equity Tier I Capital requirement and raised the capital requirements for certain capital categories. In order to be adequately capitalized for purposes of the prompt corrective action rules, a banking organization is now required to have at least an 8% Total Risk-Based Capital Ratio, a 6% Tier I Risk-Based Capital Ratio, a 4.5% Common Equity Tier I Risk Based Capital Ratio and a 4% Tier I Leverage Ratio. To be well capitalized, a banking organization is required to have at least a 10% Total Risk-Based Capital Ratio, an 8% Tier I Risk-Based Capital Ratio, a 6.5% Common Equity Tier I Risk-Based Capital Ratio and a 5% Tier I Leverage Ratio.

*Capital Buffer Requirement.* In addition to increased capital requirements, depository institutions and their holding companies will be required to maintain a capital buffer of at least 2.5% of risk-weighted assets over and above the minimum risk-based capital requirements. Institutions that do not maintain the required capital buffer will become subject to progressively more stringent limitations on the percentage of earnings that can be paid out in dividends or used for stock repurchases and on the payment of discretionary bonuses to senior executive management. The capital buffer requirement will be phased in over a four-year period beginning in 2016. The capital buffer requirement effectively raises the minimum required risk-based capital ratios to 7% Common Equity Tier I Capital, 8.5% Tier I Capital and 10.5% Total Capital on a fully phased-in basis. The capital buffer requirement for the Company begins to be phased in beginning January 1, 2016, at 0.625% of risk-weighted assets, increasing each year until fully implemented at 2.5% on January 1, 2019.

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*Additional Deductions from Capital.* Banking organizations are required to deduct goodwill and certain other intangible assets, net of associated deferred tax liabilities, from Common Equity Tier I Capital. Deferred tax assets arising from temporary timing differences that cannot be realized through net operating loss (“NOL”) carrybacks will continue to be deducted. Deferred tax assets that can be realized through NOL carrybacks are now not deducted but will be subject to 100% risk weighting. Defined benefit pension fund assets, net of any associated deferred tax liability, are now deducted from Common Equity Tier I Capital unless the banking organization has unrestricted and unfettered access to such assets. Reciprocal cross-holdings of capital instruments in any other financial institutions are now deducted from capital, not just holdings in other depository institutions. For this purpose, financial institutions are broadly defined to include securities and commodities firms, hedge and private equity funds and non-depository lenders. Banking organizations are now also required to deduct non-significant investments (less than 10% of outstanding stock) in other financial institutions to the extent these exceed 10% of Common Equity Tier I Capital subject to a 15% of Common Equity Tier I Capital cap. Greater than 10% investments must be deducted if they exceed 10% of Common Equity Tier I Capital. If the aggregate amount of certain items excluded from capital deduction due to a 10% threshold exceeds 17.65% of Common Equity Tier I Capital, the excess must be deducted.

*Changes in Risk-Weightings.* The amended regulations continue to follow the current capital rules which assign a 50% risk-weighting to “qualifying mortgage loans” which generally consist of residential first mortgages with an 80% loan-to-value ratio (or which carry mortgage insurance that reduces the bank’s exposure to 80%) that are not more than 90 days past due. All other mortgage loans continue to have a 100% risk weight. The revised regulations apply a 250% risk-weighting to mortgage servicing rights, deferred tax assets that cannot be realized through NOL carrybacks and investments in the capital instruments of other financial institutions that are not deducted from capital. The revised regulations also created a new 150% risk-weighting category for nonaccrual loans and loans that are more than 90 days past due and for “high volatility commercial real estate loans,” which are credit facilities for the acquisition, construction or development of real property other than for certain community development projects, agricultural land and one- to four-family residential properties or commercial real projects where: (i) the loan-to-value ratio is not in excess of interagency real estate lending standards; and (ii) the borrower has contributed capital equal to not less than 15% of the real estate’s “as completed” value before the loan was made.

The final rules became effective for the Company and the Bank on January 1, 2015.

We believe that both the Company and the Bank would meet all capital adequacy requirements under the fully phased-in final rules.

See “Capital Resources and Shareholders’ Equity” under Item 7 below for further discussion of regulatory capital requirements.

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### *Liquidity Requirements*

Historically, the regulation and monitoring of bank and bank holding company liquidity has been addressed as a supervisory matter, without required formulaic measures. Liquidity risk management has become increasingly important since the financial crisis. The Basel III liquidity framework requires banks and bank holding companies to measure their liquidity against specific liquidity tests that, although similar in some respects to liquidity measures historically applied by banks and regulators for management and supervisory purposes, going forward would be required by regulation. One test, referred to as the liquidity coverage ratio (“LCR”), is designed to ensure that the banking entity maintains an adequate level of unencumbered high-quality liquid assets equal to the entity’s expected net cash outflow for a 30-day time horizon (or, if greater, 25% of its expected total cash outflow) under an acute liquidity stress scenario. The other test, referred to as the net stable funding ratio (“NSFR”), is designed to promote more medium- and long-term funding of the assets and activities of banking entities over a one-year time horizon. These requirements will incent banking entities to increase their holdings of U.S. Treasury securities and other sovereign debt as a component of assets and increase the use of long-term debt as a funding source.

In September 2014, the federal bank regulators approved final rules implementing the LCR for advanced approaches banking organizations (i.e., banking organizations with \$250 billion or more in total consolidated assets or \$10 billion or more in total on-balance sheet foreign exposure) and a modified version of the LCR for bank holding companies with at least \$50 billion in total consolidated assets that are not advanced approach banking organizations, neither of which would apply to the Company or the Bank. The federal bank regulators have not yet proposed rules to implement the NSFR or addressed the scope of bank organizations to which it will apply.

### *Financial Privacy and Cybersecurity*

The federal banking regulators have adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about consumers to non-affiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a non-affiliated third party. These regulations affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors. In addition, consumers may also prevent disclosure of certain information among affiliated companies that is assembled or used to determine eligibility for a product or service, such as that shown on consumer credit reports and asset and income information from applications. Consumers also have the option to direct banks and other financial institutions not to share information about transactions and experiences with affiliated companies for the purpose of marketing products or services.

In March 2015, federal regulators issued two related statements regarding cybersecurity. One statement indicates that financial institutions should design multiple layers of security controls to establish lines of defense and to ensure that their risk management processes also address the risk posed by compromised customer credentials, including security measures to reliably authenticate customers accessing Internet-based services of the financial institution. The other statement indicates that a financial institution’s management is expected to maintain sufficient business continuity

planning processes to ensure the rapid recovery, resumption and maintenance of the institution's operations after a cyber-attack involving destructive malware. A financial institution is also expected to develop appropriate processes to enable recovery of data and business operations and address rebuilding network capabilities and restoring data if the institution or its critical service providers fall victim to this type of cyber-attack. First Bancorp has multiple Information Security Programs that reflect the requirements of this guidance. If, however, we fail to observe the regulatory guidance in the future, we could be subject to various regulatory sanctions, including financial penalties.

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Neither the Company nor the Bank can predict what other legislation might be enacted or what other regulations or assessments might be adopted.

## **Available Information**

We maintain a corporate Internet site at [www.LocalFirstBank.com](http://www.LocalFirstBank.com), which contains a link within the “Investor Relations” section of the site to each of our filings with the Securities and Exchange Commission, including our annual reports on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. These filings are available, free of charge, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. These filings can also be accessed at the Securities and Exchange Commission’s website located at [www.sec.gov](http://www.sec.gov). Information included on our Internet site is not incorporated by reference into this annual report.

## **Item 1A. Risk Factors**

An investment in our common stock involves certain risks. Before you invest in our common stock, you should be aware that there are various risks, including those described below, which could affect the value of your investment in the future. The trading price of our common stock could decline due to any of these risks, and you may lose all or part of your investment. The risk factors described in this section, as well as any cautionary language in this report, provide examples of risks, uncertainties and events that could have a material adverse effect on our business, including our operating results and financial condition. In addition to the risks and uncertainties described below, other risks and uncertainties not currently known to us, or that we currently deem to be immaterial, also may materially or adversely affect our business, financial condition, and results of operations. The value or market price of our common stock could decline due to any of these identified or other unidentified risks.

### **Unfavorable economic conditions could adversely affect our business.**

Our business is subject to periodic fluctuations based on national, regional and local economic conditions. These fluctuations are not predictable, cannot be controlled, and may have a material adverse impact on our operations and financial condition. Our banking operations are locally oriented and community-based. Our retail and commercial banking activities are primarily concentrated within the same geographic footprint. Our markets include most of North Carolina, the southwest area of Virginia and parts of South Carolina. Worsening economic conditions within our markets could have a material adverse effect on our financial condition, results of operations and cash flows. Accordingly, we expect to continue to be dependent upon local business conditions as well as conditions in the local residential and commercial real estate markets we serve. Unfavorable changes in unemployment, real estate values, interest rates and other factors could weaken the economies of the communities we serve. In recent years, economic

growth and business activity across a wide range of industries has been slow and uneven and there can be no assurance that economic conditions will continue to improve, and these conditions could worsen. In addition, oil price volatility, the level of U.S. debt and global economic conditions have had a destabilizing effect on financial markets. Weakness in any of our market areas could have an adverse impact on our earnings, and consequently our financial condition and capital adequacy.

**If our goodwill becomes impaired, we may be required to record a significant charge to earnings.**

We have goodwill recorded on our balance sheet as an asset with a carrying value as of December 31, 2015 of \$65.8 million. Under generally accepted accounting principles, goodwill is required to be tested for impairment at least annually and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The test for goodwill impairment involves comparing the fair value of a company's reporting units to their respective carrying values. For our company, our community banking operation is our only material reporting unit. The price of our common stock is one of several measures available for estimating the fair value of our community banking operations. Although the price of our common stock is currently trading above the book value, for most of the last several years, it has traded below the book value of our company. Subject to the results of other valuation techniques, if this situation were to return and persist, it could indicate that our goodwill is impaired. Accordingly, we may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill is determined, which could have a negative impact on our results of operations.

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**New capital rules that were recently issued generally require insured depository institutions and their holding companies to hold more capital. The impact of the new rules on our financial condition and operations is uncertain but could be materially adverse.**

In July 2013, the federal banking agencies approved amendments to their regulatory capital rules to conform U.S. regulatory capital rules with the international regulatory standards agreed to by the Basel Committee on

Banking Supervision in the accord referred to as “Basel III.” The new rules substantially amended the regulatory risk-based capital rules applicable to us. The rules became effective on January 1, 2015 for the Company and the Bank and will be fully phased in by January 1, 2019.

The rules include certain new and higher risk-based capital and leverage requirements than those previously in place. Specifically, the following minimum capital requirements apply to us at December 31, 2015:

- a new common equity Tier 1 risk-based capital ratio of 4.5% (fully phased-in requirement of 7%);
- a Tier 1 risk-based capital ratio of 6% (increased from the former 4% requirement; fully phased-in requirement of 8.5%);
- a total risk-based capital ratio of 8% (unchanged from the former requirement; fully phased-in requirement of 10%);
- and
- a leverage ratio of 4% (also unchanged from the former requirement).

In general, the rules have had the effect of increasing capital requirements by increasing the risk weights on certain assets, including high volatility commercial real estate, certain loans past due 90 days or more or in nonaccrual status, mortgage servicing rights not includable in Common Equity Tier 1 capital, equity exposures, and claims on securities firms, that are used in the denominator of the three risk-based capital ratios. In addition, in the current economic and regulatory environment, bank regulators may impose capital requirements that are more stringent than those required by applicable existing regulations. The application of more stringent capital requirements for us could, among other things, result in lower returns on equity, require the raising of additional capital, and result in regulatory actions if we were to be unable to comply with such requirements. Implementation of changes to asset risk weightings for risk-based capital calculations, items included or deducted in calculating regulatory capital or additional capital conservation buffers, could result in management modifying our business strategy and could limit our ability to make distributions, including paying dividends or buying back our shares.

**We might be required to raise additional capital in the future, but that capital may not be available or may not be available on terms acceptable to us when it is needed.**

We are required to maintain adequate capital levels to support our operations. In the future, we might need to raise additional capital to support growth, absorb loan losses, or meet more stringent capital requirements. Our ability to raise additional capital will depend on conditions in the capital markets at that time, which are outside our control, and



on our financial performance. Accordingly, we cannot be certain of our ability to raise additional capital in the future if needed or on terms acceptable to us. If we cannot raise additional capital when needed, our ability to conduct our business could be materially impaired.

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**The soundness of other financial institutions could adversely affect us.**

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services companies are interrelated as a result of trading, clearing, counterparty or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, and investment banks. Defaults by, or even rumors or questions about, one or more financial services companies, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. We can make no assurance that any such losses would not materially and adversely affect our business, financial condition or results of operations.

**We are subject to extensive regulation, which could have an adverse effect on our operations.**

We are subject to extensive regulation and supervision from the North Carolina Commissioner of Banks and the Federal Reserve Board. This regulation and supervision is intended primarily for the protection of the FDIC insurance fund and our depositors and borrowers, rather than for holders of our equity securities. In the past, our business has been materially affected by these regulations. This trend is likely to continue in the future.

Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on operations, the classification of our assets and the determination of the level of allowance for loan losses. Changes in the regulations that apply to us, or changes in our compliance with regulations, could have a material impact on our operations.

**Financial reform legislation enacted by the U.S. Congress, and further changes in regulation to which we are exposed, will result in additional new laws and regulations that are expected to increase our costs of operations.**

The Dodd-Frank Act has and will continue to significantly change bank regulatory structure and affect lending, deposit, investment, and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new rules and regulations, and to prepare numerous studies and reports for Congress. The federal agencies are given significant discretion in drafting and implementing the rules and regulations, and consequently, many of the details and much of the impact of the Dodd-Frank Act may not be known for many months or years. See “Legislative and Regulatory Developments – Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010” above for additional information regarding the Dodd-Frank Act.

The Dodd-Frank Act also created the Consumer Financial Protection Bureau (CFPB) and gave it broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit “unfair, deceptive or abusive” acts and practices. Additionally, the CFPB has examination and enforcement authority over all banks and savings institutions with more than \$10 billion in assets.

Proposals for further regulation of the financial services industry are continually being introduced in the United States Congress. The agencies regulating the financial services industry also periodically adopt changes to their regulations. It is possible that additional legislative proposals may be adopted or regulatory changes may be made that would have an adverse effect on our business. In addition, it is expected that such regulatory changes will increase our operating and compliance cost. We can provide no assurance regarding the manner in which new laws and regulations will affect us.

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**We are subject to interest rate risk, which could negatively impact earnings.**

Net interest income is the most significant component of our earnings. Our net interest income results from the difference between the yields we earn on our interest-earning assets, primarily loans and investments, and the rates that we pay on our interest-bearing liabilities, primarily deposits and borrowings. When interest rates change, the yields we earn on our interest-earning assets and the rates we pay on our interest-bearing liabilities do not necessarily move in tandem with each other because of the difference between their maturities and repricing characteristics. This mismatch can negatively impact net interest income if the margin between yields earned and rates paid narrows. Interest rate environment changes can occur at any time and are affected by many factors that are outside our control, including inflation, recession, unemployment trends, the Federal Reserve's monetary policy, domestic and international disorder and instability in domestic and foreign financial markets.

**Our allowance for loan losses may not be adequate to cover actual losses.**

Like all financial institutions, we maintain an allowance for loan losses to provide for probable losses caused by customer loan defaults. The allowance for loan losses may not be adequate to cover actual loan losses, and in this case additional and larger provisions for loan losses would be required to replenish the allowance. Provisions for loan losses are a direct charge against income.

We establish the amount of the allowance for loan losses based on historical loss rates, as well as estimates and assumptions about future events. Because of the extensive use of estimates and assumptions, our actual loan losses could differ, possibly significantly, from our estimate. We believe that our allowance for loan losses is adequate to provide for probable losses, but it is possible that the allowance for loan losses will need to be increased for credit reasons or that regulators will require us to increase this allowance. Either of these occurrences could materially and adversely affect our earnings and profitability.

In addition, the measure of our allowance for loan losses is dependent on the adoption of new accounting standards. The Financial Accounting Standards Board recently issued a proposed Accounting Standards Update that presents a new credit impairment model, the Current Expected Credit Loss ("CECL") model, which would require financial institutions to estimate and develop a provision for credit losses at origination for the lifetime of the loan, as opposed to reserving for probable incurred losses up to the balance sheet date. Under the CECL model, credit deterioration would be reflected in the income statement in the period of origination or acquisition of the loan, with changes in expected credit losses due to further credit deterioration or improvement reflected in the periods in which the expectation changes. Accordingly, the CECL model could require financial institutions like the Bank to increase their allowances for loan losses. Moreover, the CECL model likely would create more volatility in our level of allowance for loan losses.

**In the normal course of business, we process large volumes of transactions involving millions of dollars. If our internal controls fail to work as expected, if our systems are used in an unauthorized manner, or if our employees subvert our internal controls, we could experience significant losses.**

We process large volumes of transactions on a daily basis and are exposed to numerous types of operational risk. Operational risk includes the risk of fraud by persons inside or outside the Company, the execution of unauthorized transactions by employees, errors relating to transaction processing and systems and breaches of the internal control system and compliance requirements. This risk also includes potential legal actions that could arise as a result of an operational deficiency or as a result of noncompliance with applicable regulatory standards.

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We establish and maintain systems of internal operational controls that provide us with timely and accurate information about our level of operational risk. Although not foolproof, these systems have been designed to manage operational risk at appropriate, cost-effective levels. Procedures exist that are designed to ensure that policies relating to conduct, ethics, and business practices are followed. From time to time, losses from operational risk may occur, including the effects of operational errors. We continually monitor and improve our internal controls, data processing systems, and corporate-wide processes and procedures, but there can be no assurance that future losses will not occur.

**We face a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.**

The federal Bank Secrecy Act, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (which we refer to as the “Patriot Act”) and other laws and regulations require financial institutions, among other duties, to institute and maintain effective anti-money laundering programs and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network, established by the U.S. Treasury Department to administer the Bank Secrecy Act, is authorized to impose significant civil money penalties for violations of those requirements and has recently engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. There is also increased scrutiny of compliance with the rules enforced by the OFAC. Federal and state bank regulators also have begun to focus on compliance with Bank Secrecy Act and anti-money laundering regulations. If our policies, procedures and systems are deemed deficient or the policies, procedures and systems of the financial institutions that we have already acquired or may acquire in the future are deficient, we would be subject to liability, including fines and regulatory actions such as restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, including our acquisition plans, which would negatively impact our business, financial condition and results of operations. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us.

**Federal, state and local consumer lending laws restrict our ability to originate certain mortgage loans and increase our risk of liability with respect to such loans and increase our cost of doing business.**

Federal, state and local laws have been adopted that are intended to eliminate certain lending practices considered “predatory.” These laws prohibit practices such as steering borrowers away from more affordable products, selling unnecessary insurance to borrowers, repeatedly refinancing loans and making loans without a reasonable expectation that the borrowers will be able to repay the loans irrespective of the value of the underlying property. Over the course of 2013, the CFPB issued several rules on mortgage lending, notably a rule requiring all home mortgage lenders to determine a borrower’s ability to repay the loan. Loans with certain terms and conditions and that otherwise meet the definition of a “qualified mortgage” may be protected from liability to a borrower for failing to make the necessary determinations. We may find it necessary to tighten our mortgage loan underwriting standards in response to the CFPB rules, which may constrain our ability to make loans consistent with our business strategies. It is our policy not to make predatory loans and to determine borrowers’ ability to repay, but the law and related rules create the potential for increased liability with respect to our lending and loan investment activities. They increase our cost of doing

business and, ultimately, may prevent us from making certain loans and cause us to reduce the average percentage rate or the points and fees on loans that we do make.

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**We are subject to federal and state fair lending laws, and failure to comply with these laws could lead to material penalties.**

Federal and state fair lending laws and regulations, such as the Equal Credit Opportunity Act and the Fair Housing Act, impose nondiscriminatory lending requirements on financial institutions. The Department of Justice, CFPB and other federal and state agencies are responsible for enforcing these laws and regulations. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. A successful challenge to our performance under the fair lending laws and regulations could adversely impact our rating under the Community Reinvestment Act and result in a wide variety of sanctions, including the required payment of damages and civil money penalties, injunctive relief, imposition of restrictions on merger and acquisition activity and restrictions on expansion activity, which could negatively impact our reputation, business, financial condition and results of operations.

**Negative public opinion regarding our company and the financial services industry in general, could damage our reputation and adversely impact our earnings.**

Reputation risk, or the risk to our business, earnings and capital from negative public opinion regarding our company and the financial services industry in general, is inherent in our business. Negative public opinion can result from actual or alleged conduct in any number of activities, including lending practices, corporate governance and acquisitions, and from actions taken by government regulators and community organizations in response to those activities. Negative public opinion can adversely affect our ability to keep and attract clients and employees and can expose us to litigation and regulatory action. Although we have taken steps to minimize reputation risk in dealing with our clients and communities, this risk will always be present given the nature of our business.

**We could experience a loss due to competition with other financial institutions.**

We face substantial competition in all areas of our operations from a variety of different competitors, both within and beyond our principal markets, many of which are larger and may have more financial resources. Such competitors primarily include national, regional and internet banks within the various markets in which we operate. We also face competition from many other types of financial institutions, including, without limitation, savings and loans, credit unions, finance companies, brokerage firms, insurance companies and other financial intermediaries. The financial services industry could become even more competitive as a result of legislative and regulatory changes and continued consolidation. In addition, as customer preferences and expectations continue to evolve, technology has lowered barriers to entry and made it possible for nonbanks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Banks, securities firms and insurance companies can merge under the umbrella of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting) and merchant banking. Also, technology has lowered barriers to entry and made it possible for nonbanks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Many of our competitors have fewer regulatory



constraints and may have lower cost structures. Additionally, due to their size, many competitors may be able to achieve economies of scale and, as a result, may offer a broader range of products and services as well as better pricing for those products and services than we can.

Our ability to compete successfully depends on a number of factors, including, among other things:

the ability to develop, maintain, and build upon long-term customer relationships based on top quality service, high ethical standards, and safe, sound assets;

the ability to expand our market position;

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- the scope, relevance, and pricing of products and services offered to meet customer needs and demands;
- the rate at which we introduce new products and services relative to our competitors;
- customer satisfaction with our level of service; and
- industry and general economic trends.

Failure to perform in any of these areas could significantly weaken our competitive position, which could adversely affect our growth and profitability, which, in turn, could have a material adverse effect on our financial condition and results of operations.

**Failure to keep pace with technological change could adversely affect our business.**

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on our business and, in turn, our financial condition and results of operations.

**New lines of business or new products and services may subject us to additional risk.**

From time to time, we may implement new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. In developing and marketing new lines of business and/or new products and services, we may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business and/or a new product or service. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of our system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business and/or new products or services could have a material adverse effect on our business and, in turn, our financial condition and results of operations.

**Consumers may decide not to use banks to complete their financial transactions.**

Technology and other changes are allowing parties to complete financial transactions through alternative methods that historically have involved banks. For example, consumers can now maintain funds that would have historically been held as bank deposits in brokerage accounts, mutual funds or general-purpose reloadable prepaid cards. Consumers can also complete transactions such as paying bills and/or transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries, known as “disintermediation,” could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the lower cost of deposits as a source of funds could have a material adverse effect on our financial condition and results of operations.

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**Our reported financial results are impacted by management's selection of accounting methods and certain assumptions and estimates.**

Our accounting policies and methods are fundamental to the way we record and report our financial condition and results of operations. Our management must exercise judgment in selecting and applying many of these accounting policies and methods so they comply with generally accepted accounting principles and reflect management's judgment of the most appropriate manner to report our financial condition and results. In some cases, management must select the accounting policy or method to apply from two or more alternatives, any of which may be reasonable under the circumstances, yet may result in reporting materially different results than would have been reported under a different alternative.

Certain accounting policies are critical to presenting our financial condition and results. They require management to make difficult, subjective or complex judgments about matters that are uncertain. Materially different amounts could be reported under different conditions or using different assumptions or estimates. These critical accounting policies include: the allowance for loan losses; intangible assets; and the fair value and discount accretion of loans acquired in FDIC-assisted transactions.

**There can be no assurance that we will continue to pay cash dividends.**

Although we have historically paid cash dividends, there is no assurance that we will continue to pay cash dividends. Future payment of cash dividends, if any, will be at the discretion of our board of directors and will be dependent upon our financial condition, results of operations, capital requirements, economic conditions, and such other factors as the board may deem relevant.

**Future sales of our stock by our shareholders or the perception that those sales could occur may cause our stock price to decline.**

Although our common stock is listed for trading in The NASDAQ Global Select Market under the symbol FBNC, the trading volume in our common stock is lower than that of other larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of our common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the relatively low trading volume of our common stock, significant sales of our common stock in the public market, or the perception that those sales may occur, could cause the trading price of our common stock to decline or to be lower than it otherwise might be in the absence of those sales or perceptions.

**Our business continuity plans or data security systems could prove to be inadequate, resulting in a material interruption in, or disruption to, our business and a negative impact on our results of operations.**

We rely heavily on communications and information systems to conduct our business. Our daily operations depend on the operational effectiveness of our technology. We rely on our systems to accurately track and record our assets and liabilities. Any failure, interruption or breach in security of our computer systems or outside technology, whether due to severe weather, natural disasters, acts of war or terrorism, criminal activity, cyber-attacks or other factors, could result in failures or disruptions in general ledger, deposit, loan, customer relationship management, and other systems leading to inaccurate financial records. This could materially affect our business operations and financial condition. While we have disaster recovery and other policies and procedures designed to prevent or limit the effect of any failure, interruption or security breach of our information systems, there can be no assurance that any such failures, interruptions, or security breaches will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our results of operations.

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In addition, the Bank provides its customers the ability to bank online and through mobile banking. The secure transmission of confidential information over the Internet is a critical element of online and mobile banking. While we use qualified third party vendors to test and audit our network, our network could become vulnerable to unauthorized access, computer viruses, phishing schemes and other security issues. The Bank may be required to spend significant capital and other resources to alleviate problems caused by security breaches or computer viruses. To the extent that the Bank's activities or the activities of its customers involve the storage and transmission of confidential information, security breaches and viruses could expose the Bank to claims, litigation, and other potential liabilities. Any inability to prevent security breaches or computer viruses could also cause existing customers to lose confidence in the Bank's systems and could adversely affect its reputation and its ability to generate deposits.

Additionally, we outsource the processing of our core data system, as well as other systems such as online banking, to third party vendors. Prior to establishing an outsourcing relationship, and on an ongoing basis thereafter, management monitors key vendor controls and procedures related to information technology, which includes reviewing reports of service auditor's examinations. If our third party provider encounters difficulties or if we have difficulty in communicating with such third party, it will significantly affect our ability to adequately process and account for customer transactions, which would significantly affect our business operations.

### **We rely on certain external vendors.**

We are reliant upon certain external vendors to provide products and services necessary to maintain our day-to-day operations. Accordingly, our operations are exposed to risk that these vendors will not perform in accordance with applicable contractual arrangements or service level agreements. We maintain a system of policies and procedures designed to monitor vendor risks including, among other things, (i) changes in the vendor's organizational structure, (ii) changes in the vendor's financial condition and (iii) changes in the vendor's support for existing products and services. While we believe these policies and procedures help to mitigate risk, and our vendors are not the sole source of service, the failure of an external vendor to perform in accordance with applicable contractual arrangements or the service level agreements could be disruptive to our operations, which could have a material adverse impact on the our business and its financial condition and results of operations.

**Our potential inability to integrate companies we may acquire in the future could expose us to financial, execution, and operational risks that could negatively affect our financial condition and results of operations. Acquisitions may be dilutive to common shareholders and FDIC-assisted transactions have additional compliance risk that other acquisitions do not have.**

On occasion, we may engage in a strategic acquisition when we believe there is an opportunity to strengthen and expand our business. In addition, such acquisitions may involve the issuance of stock, which may have a dilutive effect on earnings per share. To fully benefit from such acquisition, however, we must integrate the administrative, financial, sales, lending, collections, and marketing functions of the acquired company. If we are unable to successfully integrate an acquired company, we may not realize the benefits of the acquisition, and our financial

results may be negatively affected. A completed acquisition may adversely affect our financial condition and results of operations, including our capital requirements and the accounting treatment of the acquisition. Completed acquisitions may also lead to exposure from potential asset quality issues, losses of key employees or customers, difficulty and expense of integrating operations and systems, and significant unexpected liabilities after the consummation of these acquisitions. In addition, if we were to conclude that the value of an acquired business had decreased and that the related goodwill had been impaired, that conclusion would result in a goodwill impairment charge, which would adversely affect our results of operations.

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We may have opportunities to acquire the assets and liabilities of failed banks in FDIC-assisted transactions. Although these transactions typically provide for FDIC assistance to an acquirer to mitigate certain risks, such as sharing exposure to loan losses and providing indemnification against certain liabilities of the failed institution, we are (and would be in future transactions) subject to many of the same risks we would face in acquiring another bank in a negotiated transaction, including risks associated with maintaining customer relationships and failure to realize the anticipated acquisition benefits in the amounts and within the time frames we expect. In addition, ongoing compliance risk under the loss-share agreement with the FDIC is considerable and the event of noncompliance could result in coverage under the loss-share being disallowed, thus increasing the actual losses to the Bank. Our inability to overcome these risks could have a material adverse effect on our business, financial condition and results of operations.

### **Our FDIC loss share agreement related to a high risk loan portfolio acquired in a failed-bank acquisition expires on March 31, 2016, and therefore we will bear the full risk of losses for assets currently under that agreement subsequent to that date.**

On January 21, 2011, we acquired The Bank of Asheville in a FDIC failed-bank acquisition. As part of the terms of the acquisition, we entered into two loss share agreements with the FDIC – 1) a loss share agreement related to single-family home loans, which has a ten year term, and 2) a loss share agreement for all non-single family loans, which has a five year term. The loss share agreements generally provide us with an 80% reimbursement for all losses incurred and thus they limit our risk. The non-single family loss share agreement related to The Bank of Asheville expires on March 31, 2016. The assets covered by the non-single family portfolio include a high percentage of commercial real estate and land development loans, loan types which experienced high loss rates during the economic downturn.

At December 31, 2015, the carrying value of the assets covered by The Bank of Asheville non-single family loss-share agreement was approximately \$18 million in loans, of which \$3 million were on nonaccrual status because of collection problems, and \$0.3 million in foreclosed properties. Accounting regulations require us to record losses as they occur, and thus we believe that we have recorded all probable losses associated with that portfolio as of each period end. However, the value of the underlying collateral for many of the loans, as well as the foreclosed properties, is volatile and has experienced significant declines in recent years. Beginning April 1, 2016, we will incur 100% of the loss related to further deterioration of The Bank of Asheville non-single family assets.

### **Our ability to receive benefits under FDIC loss share agreements is subject to compliance with certain requirements, oversight and interpretation, and contractual term limitations.**

We receive benefits under loss share agreements with the FDIC in connection with the FDIC-assisted acquisitions of Cooperative Bank in June 2009 and The Bank of Asheville in January 2011. Under these loss share agreements, the FDIC agreed to cover 80% of most loan and foreclosed real estate losses. We are subject to certain obligations under these agreements that prescribe and specify how to manage, service, report, and request reimbursement for losses incurred on covered assets. Our obligations under the loss share agreements are extensive, and failure to comply with any obligations could result in a specific asset, or group of assets, losing loss share coverage. Requests for reimbursement are subject to FDIC review and may be delayed or disallowed if we are not in compliance with our obligations. Losses projected to occur during the loss share term may not be realized until after the expiration of the



applicable agreement; consequently, those losses may have a material adverse impact on our results of operations. In addition, we are subject to FDIC audits to ensure compliance with the loss share agreements. The loss share agreements are subject to interpretation by us and the FDIC; therefore, disagreements may arise regarding the coverage of losses, expenses, and contingencies.

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**Item 1B. Unresolved Staff Comments**

None

**Item 2. Properties**

The main offices of the Company and the Bank are owned by the Bank and are located in a three-story building in the central business district of Southern Pines, North Carolina. The building houses administrative facilities. The Bank's Operations Division, including customer accounting functions, offices for information technology operations, and offices for loan operations, are housed in two one-story steel frame buildings in Troy, North Carolina. Both of these buildings are owned by the Bank. The Company operates 88 bank branches. The Company owns all of its bank branch premises except 10 branch offices for which the land and buildings are leased and eight branch offices for which the land is leased but the building is owned. The Company also leases two loan production offices. There are no options to purchase or lease additional properties. The Company considers its facilities adequate to meet current needs and believes that lease renewals or replacement properties can be acquired as necessary to meet future needs.

**Item 3. Legal Proceedings**

Various legal proceedings may arise in the ordinary course of business and may be pending or threatened against the Company and its subsidiaries. Neither the Company nor any of its subsidiaries is involved in any pending legal proceedings that management believes are material to the Company or its consolidated financial position. If an exposure were to be identified, it is the Company's policy to establish and accrue appropriate reserves during the accounting period in which a loss is deemed to be probable and the amount is determinable.

There were no tax shelter penalties assessed by the Internal Revenue Service against the Company during the year ended December 31, 2015.

**Item 4. Mine Safety Disclosure**

Not applicable.



Table of Contents**PART II****Item 5. Market for the Registrant's Common Stock, Related Shareholder Matters, and Issuer Purchases of Equity Securities**

Our common stock trades on The NASDAQ Global Select Market under the symbol FBNC. Table 22, included in "Management's Discussion and Analysis" below, sets forth the high and low market prices of our common stock as traded by the brokerage firms that maintain a market in our common stock and the dividends declared for the periods indicated. We paid a cash dividend of \$0.08 per share for each quarter of 2015. For the foreseeable future, it is our current intention to continue to pay regular cash dividends on a quarterly basis. See "Business - Supervision and Regulation" above and Note 16 to the consolidated financial statements for a discussion of other regulatory restrictions on the Company's payment of dividends. As of December 31, 2015, there were approximately 2,300 shareholders of record and another 3,100 shareholders whose stock is held in "street name."

There were no sales of unregistered securities during the year ended December 31, 2015.

**Additional Information Regarding the Registrant's Equity Compensation Plans**

At December 31, 2015, the Company had three equity-based compensation plans. The Company's 2014 Equity Plan is the only one of three plans under which new grants of equity-based awards are possible.

The following table presents information as of December 31, 2015 regarding shares of the Company's stock that may be issued pursuant to the Company's equity based compensation plans. At December 31, 2015, the Company had no warrants or stock appreciation rights outstanding under any compensation plans.

| Plan category | As of December 31, 2015                                 |  |   |
|---------------|---|--|---|
|               | (a)<br>Number<br>of<br>securities<br>to<br>be<br>issued | (b)<br>Weighted-average<br>exercise price<br>of<br>outstanding<br>options,<br>warrants and | (c)<br>Number of securities<br>available for<br>future issuance under<br>equity<br>compensation plans<br>(excluding |
|               |   |  |   |

|  | upon<br>exercise<br>of<br>outstanding<br>options,<br>warrants<br>and<br>rights | rights   | securities reflected in<br>column (a)) |
|--|--|----------|--|
| Equity compensation plans approved by security holders (1) | 117,408  | \$ 18.12 | 919,659                                |
| Equity compensation plans not approved by security holders | —  | —        | —                                      |
| Total  | 117,408  | \$ 18.12 | 919,659                                |

(1) Consists of (A) the Company's 2014 Equity Plan, which is currently in effect; (B) the Company's 2007 Equity Plan; and (C) the Company's 2004 Stock Option Plan, each of which was approved by our shareholders.

Table of Contents**Performance Graph**

The performance graph shown below compares the Company's cumulative total return to shareholders for the five-year period commencing December 31, 2010 and ending December 31, 2015, with the cumulative total return of the Russell 2000 Index (reflecting overall stock market performance of small-capitalization companies), and an index of banks with between \$1 billion and \$5 billion in assets, as constructed by SNL Securities, LP (reflecting changes in banking industry stocks). The graph and table assume that \$100 was invested on December 31, 2010 in each of the Company's common stock, the Russell 2000 Index, and the SNL Bank Index, and that all dividends were reinvested.

First Bancorp

Comparison of Five-Year Total Return Performances (1)

Five Years Ending December 31, 2015

|   | Total Return Index Values (1) |       |        |        |        |        |
|---|-------------------------------|-------|--------|--------|--------|--------|
|   | December 31,                  |       |        |        |        |        |
|   | 2010                          | 2011  | 2012   | 2013   | 2014   | 2015   |
| First Bancorp                                       | \$100.00                      | 74.98 | 88.77  | 117.63 | 133.07 | 137.48 |
| Russell 2000  | 100.00                        | 95.82 | 111.49 | 154.78 | 162.35 | 155.18 |
| SNL Index-Banks between \$1 billion and \$5 billion | 100.00                        | 91.20 | 112.45 | 163.52 | 170.98 | 191.39 |

Notes:

Total return indices were provided from an independent source, SNL Securities LP, Charlottesville, Virginia, and (1) assume initial investment of \$100 on December 31, 2010, reinvestment of dividends, and changes in market values.

Total return index numerical values used in this example are for illustrative purposes only.

Table of Contents**Issuer Purchases of Equity Securities**

Pursuant to authorizations by the Company's board of directors, the Company has from time to time repurchased shares of common stock in private transactions and in open-market purchases. The most recent board authorization was announced on July 30, 2004 and authorized the repurchase of 375,000 shares of the Company's stock. The Company did not repurchase any shares of its common stock during the quarter ended December 31, 2015.

## Issuer Purchases of Equity Securities

| Period   | Total<br>Number of<br>Shares<br>Purchased<br>(2) | Average<br>Price<br>Paid Per<br>Share | Total<br>Number of<br>Shares<br>Purchased as<br>Part of<br>Publicly<br>Announced<br>Plans or<br>Programs (1) | Maximum Number<br>of<br>Shares That May<br>Yet Be<br>Purchased Under<br>the Plans<br>or Programs (1) |
|--|--|---------------------------------------|--|--|
| Month #1 (October 1, 2015 to October 31, 2015)   | —  | \$ —                                  | —  | 214,241  |
| Month #2 (November 1, 2015 to November 30, 2015) | —  | —                                     | —  | 214,241  |
| Month #3 (December 1, 2015 to December 31, 2015) | —  | —                                     | —  | 214,241  |
| Total  | —  | \$ —                                  | —  | 214,241  |

## Footnotes to the Above Table

All shares available for repurchase are pursuant to publicly announced share repurchase authorizations. On July 30, 2004, the Company announced that its board of directors had approved the repurchase of 375,000 shares of the (1) Company's common stock. The repurchase authorization does not have an expiration date. There are no plans or programs the Company has determined to terminate prior to expiration, or under which the Company does not intend to make further purchases.

The table above does not include shares that were used by option holders to satisfy the exercise price of the call (2) options issued by the Company to its employees and directors pursuant to the Company's stock option plans. There were no such exercises during the three months ended December 31, 2015.

**Item 6. Selected Consolidated Financial Data**

Table 1 on page 75 of this report sets forth the selected consolidated financial data for the Company.





Table of Contents**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

Management's Discussion and Analysis is intended to assist readers in understanding our results of operations and changes in financial position for the past three years. This review should be read in conjunction with the consolidated financial statements and accompanying notes beginning on page 94 of this report and the supplemental financial data contained in Tables 1 through 22 included with this discussion and analysis.

**Overview - 2015 Compared to 2014**

We reported net income per diluted common share of \$1.30 in 2015, a 9.2% increase compared to 2014. The increased earnings were primarily due to lower provisions for loan losses. Total assets increased by 4.5% year over year.

## Financial Highlights

| <i>(\$ in thousands except per share data)</i> | 2015        | 2014      | Change  |
|--|-------------|-----------|---------|
| <b>Earnings</b>                                |             |           |         |
| Net interest income                            | \$119,747   | 131,609   | -9.0 %  |
| Provision for loan losses - non-covered        | 2,008       | 7,087     | -71.7 % |
| Provision (reversal) for loan losses - covered | (2,788 )    | 3,108     | n/m     |
| Noninterest income                             | 18,764      | 14,368    | 30.6 %  |
| Noninterest expenses                           | 98,131      | 97,251    | 0.9 %   |
| Income before income taxes                     | 41,160      | 38,531    | 6.8 %   |
| Income tax expense                             | 14,126      | 13,535    | 4.4 %   |
| Net income                                     | 27,034      | 24,996    | 8.2 %   |
| Preferred stock dividends                      | (603 )      | (868 )    |         |
| Net income available to common shareholders    | \$26,431    | 24,128    | 9.5 %   |
| <b>Net income per common share</b>             |             |           |         |
| Basic  | \$1.34      | 1.22      | 9.8 %   |
| Diluted  | 1.30        | 1.19      | 9.2 %   |
| <b>Balances At Year End</b>                    |             |           |         |
| Assets   | \$3,362,065 | 3,218,383 | 4.5 %   |
| Loans  | 2,518,926   | 2,396,174 | 5.1 %   |
| Deposits                                       | 2,811,285   | 2,695,906 | 4.3 %   |
| <b>Ratios</b>                                  |             |           |         |
| Return on average assets                       | 0.82        | % 0.75    | %       |
| Return on average common equity                | 8.04        | % 7.73    | %       |
| Net interest margin (taxable-equivalent)       | 4.13        | % 4.58    | %       |

n/m – not meaningful

The following is a more detailed discussion of our results for 2015 compared to 2014:

For the year ended December 31, 2015, we reported net income available to common shareholders of \$26.4 million, or \$1.30 per diluted common share, an increase of 9.5% compared to the \$24.1 million, or \$1.19 per diluted common share, for the year ended December 31, 2014. The higher earnings were primarily the result of lower provisions for loan losses.

Net interest income for the year ended December 31, 2015 amounted to \$119.7 million, a 9.0% decrease from the \$131.6 million recorded in 2014. The lower net interest income in 2015 was primarily due to a decrease in the amount of discount accretion recorded on loans purchased in failed bank acquisitions. For the full year of 2015, loan discount accretion amounted to \$4.8 million compared to \$16.0 million for 2014. The lower amount of accretion is due to the continued winding down of the unaccreted discount amount that resulted from failed-bank acquisitions in 2009 and 2011. As discussed below, the impact of the changes in discount accretion on pretax income is generally 20% of the gross amount of the change. Also, see the section entitled “Net Interest Income” for additional information.

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Our net interest margin (tax-equivalent net interest income divided by average earning assets) was 4.13% for 2015 compared to 4.58% for 2014. The lower margin in 2015 compared to 2014 was primarily due to lower amounts of discount accretion on loans purchased in failed-bank acquisitions. Partially offsetting the effects of lower discount accretion was a decline in our cost of funds, which declined from 0.29% in 2014 to 0.24% in 2015.

We recorded negative total provisions for loan losses (reduction of the allowance for loan losses) on our covered and non-covered loans of \$0.8 million in 2015 compared to provision for loan losses of \$10.2 million for 2014 – see discussion of the term “covered” below. The provision for loan losses on non-covered loans amounted to \$2.0 million in 2015 compared to \$7.1 million for 2014. The lower provision recorded in 2015 was primarily a result of continued favorable credit quality trends and generally improving economic trends. For the year ended December 31, 2015, we recorded a negative provision for loan losses on covered loans of \$2.8 million compared to a \$3.1 million provision for loan losses in 2014. The negative provision in 2015 primarily resulted from lower levels of covered nonperforming loans, declining levels of total covered loans, and net loan recoveries (recoveries, net of charge-offs) of \$2.3 million that were realized during the year ended December 31, 2015.

Our non-covered nonperforming assets declined 19.0% during 2015, amounting to \$77.2 million at December 31, 2015 (2.37% of total non-covered assets) compared to \$95.3 million at December 31, 2014 (3.09% of total non-covered assets). The decline in non-covered nonperforming assets is primarily due to on-going resolution of nonperforming assets and improving credit quality.

Total covered nonperforming assets also declined in 2015, amounting to \$12.1 million at December 31, 2015 compared to \$18.7 million at December 31, 2014. We continue to have success resolving our covered loans, and property sales along the North Carolina coast remain strong, which is where most of the Company’s covered assets are located.

For the year ended December 31, 2015, noninterest income amounted to \$18.8 million compared to \$14.4 million for the year ended December 31, 2014. The increase in 2015 was primarily the result of lower FDIC indemnification asset expense, which is recorded as a reduction to noninterest income. FDIC indemnification asset expense amounted to \$8.6 million in 2015, a \$4.2 million decrease from the \$12.8 million recorded in 2014, with the lower expense being due to a lower amount of write-offs of the FDIC indemnification asset, which is associated with the continued winding down of our loss share assets.

Noninterest expenses for the year ended December 31, 2015 amounted to \$98.1 million, which was relatively unchanged from the \$97.3 million recorded in 2014.

Total assets at December 31, 2015 amounted to \$3.4 billion, a 4.5% increase from a year earlier. Total loans at December 31, 2015 amounted to \$2.5 billion, a 5.1% increase from a year earlier, and total deposits amounted to \$2.8

billion at December 31, 2015, a 4.3% increase from a year earlier.

Non-covered loans amounted to \$2.42 billion at December 31, 2015, an increase of \$147.7 million, or 6.5% from December 31, 2014, as a result of ongoing internal initiatives to drive loan growth. Loans covered by FDIC loss share agreements declined 19.6% in 2015 as those loans continued to pay down.

The increase in total deposits at December 31, 2015 compared to December 31, 2014 was primarily due to increases in checking, money market and savings accounts, which increased in total by \$236.5 million, or 12.6%, during 2015. Those increases were partially offset by decreases in time deposits, which declined a total of \$121.1 million, or 14.7%, during 2015. Time deposits are generally one of our most expensive funding sources, and thus the shift from this category has reduced our overall cost of funds.

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On June 25, 2015, we redeemed \$32 million (32,000 shares) of the outstanding Non-Cumulative Perpetual Preferred Stock, Series B (“SBLF Stock”) that had been issued to the United States Secretary of the Treasury in September 2011 related to our participation in the Small Business Lending Fund. On October 16, 2015, the remaining \$31.5 million of SBLF Stock was redeemed, which ended our participation in the Small Business Lending Fund.

We note that our results of operation discussed above are significantly affected by the on-going accounting for two FDIC-assisted failed bank acquisitions. In the discussion in this document, the term “covered” is used to describe assets included as part of FDIC loss share agreements, which generally result in the FDIC reimbursing the Company for 80% of losses incurred on those assets. The term “non-covered” refers to our legacy assets, which are not included in any type of loss share arrangement.

For covered loans that deteriorate in terms of repayment expectations, we record immediate allowances through the provision for loan losses. For covered loans that experience favorable changes in credit quality compared to what was expected at the acquisition date, including loans that payoff, we record positive adjustments to interest income over the life of the respective loan – also referred to as loan discount accretion. For covered foreclosed properties that are sold at gains or losses or that are written down to lower values, we record the gains/losses within noninterest income.

The adjustments discussed above are recorded within the income statement line items noted without consideration of the FDIC loss share agreements. Because favorable changes in covered assets result in lower expected FDIC claims, and unfavorable changes in covered assets result in higher expected FDIC claims, the FDIC indemnification asset is adjusted to reflect those expectations. The net increase or decrease in the indemnification asset is reflected within noninterest income.

The adjustments noted above can result in volatility within individual income statement line items. Because of the FDIC loss share agreements and the associated indemnification asset, pretax income resulting from amounts recorded as provisions for loan losses on covered loans, discount accretion, and losses from covered foreclosed properties is generally only impacted by 20% of these amounts due to the corresponding adjustments made to the indemnification asset.

Table of Contents**Overview - 2014 Compared to 2013**

We reported net income per diluted common share of \$1.19 in 2014, a 21.4% increase compared to 2013. The increased earnings were primarily due to lower provisions for loan losses. Total assets increased by 1% year over year.

**Financial Highlights**

| <i>(\$ in thousands except per share data)</i> | 2014        | 2013      | Change |
|--|-------------|-----------|--------|
| <b>Earnings</b>                                |             |           |        |
| Net interest income                            | \$131,609   | 136,526   | -3.6%  |
| Provision for loan losses - non-covered        | 7,087       | 18,266    | -61.2% |
| Provision for loan losses - covered            | 3,108       | 12,350    | -74.8% |
| Noninterest income                             | 14,368      | 23,489    | -38.8% |
| Noninterest expenses                           | 97,251      | 96,619    | 0.7%   |
| Income before income taxes                     | 38,531      | 32,780    | 17.5%  |
| Income tax expense                             | 13,535      | 12,081    | 12.0%  |
| Net income                                     | 24,996      | 20,699    | 20.8%  |
| Preferred stock dividends                      | (868 )      | (895 )    |        |
| Net income available to common shareholders    | \$24,128    | 19,804    | 21.8%  |
| <b>Net income per common share</b>             |             |           |        |
| Basic  | \$1.22      | 1.01      | 20.8%  |
| Diluted  | 1.19        | 0.98      | 21.4%  |
| <b>Balances At Year End</b>                    |             |           |        |
| Assets   | \$3,218,383 | 3,185,070 | 1.0%   |
| Loans  | 2,396,174   | 2,463,194 | -2.7%  |
| Deposits                                       | 2,695,906   | 2,751,019 | -2.0%  |
| <b>Ratios</b>                                  |             |           |        |
| Return on average assets                       | 0.75%       | 0.62%     |        |
| Return on average common equity                | 7.73%       | 6.78%     |        |
| Net interest margin (taxable-equivalent)       | 4.58%       | 4.92%     |        |

The following is a more detailed discussion of our results for 2014 compared to 2013:

For the year ended December 31, 2014, we reported net income available to common shareholders of \$24.1 million, or \$1.19 per diluted common share, an increase of 21.8% compared to the \$19.8 million, or \$0.98 per diluted common

share, for the year ended December 31, 2013. The higher earnings were primarily the result of lower provisions for loan losses.

Net interest income for the year ended December 31, 2014 amounted to \$131.6 million, a 3.6% decrease from the \$136.5 million recorded in 2013. The lower net interest income in 2014 was primarily due to a decrease in the amount of discount accretion on loans purchased in failed bank acquisitions. Loan discount accretion amounted to \$16.0 million in 2014 compared to \$20.2 million in 2013, a decrease of \$4.2 million. The impact of the changes in discount accretion on pretax income is generally 20% of the gross amount of the change.

Our net interest margin (tax-equivalent net interest income divided by average earning assets) was 4.58% for 2014 compared to 4.92% for 2013. The lower margin realized in 2014 was primarily due to lower amounts of discount accretion on loans purchased in failed-bank acquisitions and lower average asset yields. Partially offsetting the effects of lower discount accretion and lower average asset yields was a decline in our cost of funds, which declined from 0.39% in 2013 to 0.29% in 2014.

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We recorded total provisions for loan losses on our covered and non-covered loans of \$10.2 million in 2014 compared to \$30.6 million for 2013. The provision for loan losses on non-covered loans amounted to \$7.1 million in 2014 compared to \$18.3 million for 2013. The lower provision recorded in 2014 was primarily a result of stable asset quality trends and a decline in non-covered loan balances (excluding the transfer of \$39.7 million in loans from covered status to non-covered status on July 1, 2014 – see discussion below). For the year ended December 31, 2014, the provision for loan losses on covered loans amounted to \$3.1 million compared to \$12.4 million for 2013. The decrease in 2014 was primarily due to lower levels of covered nonperforming loans during the period and stabilization in the underlying collateral values of nonperforming loans.

Our non-covered nonperforming assets amounted to \$95.3 million at December 31, 2014 (3.09% of total non-covered assets) compared to \$82.0 million at December 31, 2013 (2.78% of total non-covered assets). The increase in 2014 was due to the Company transferring \$14.8 million in nonperforming assets from covered status to non-covered status on July 1, 2014 upon the scheduled expiration of a loss sharing agreement with the FDIC associated with those assets – see discussion below.

Total covered nonperforming assets have declined in the past year, amounting to \$18.7 million at December 31, 2014 compared to \$70.6 million at December 31, 2013. During 2014 we resolved a significant amount of covered loans and experienced strong property sales along the North Carolina coast, which is where most of our covered assets are located. Also, as discussed in the preceding paragraph, on July 1, 2014 the Company transferred \$14.8 million in nonperforming assets from covered status to non-covered status upon the expiration of a loss sharing agreement.

For the year ended December 31, 2014, noninterest income amounted to \$14.4 million compared to \$23.5 million for 2013. The decrease in 2014 was primarily the result of higher FDIC indemnification asset expense, which is recorded as a reduction to noninterest income. FDIC indemnification expense amounted to \$12.8 million in 2014, an increase from \$6.8 million in 2013, with the higher expense being primarily the result of write-offs of the FDIC indemnification asset due to lower expected FDIC reimbursements resulting from lower expectations of loss claims. Also contributing to lower noninterest income in 2014 were higher levels of foreclosed property losses compared to 2013.

Noninterest expenses for the year ended December 31, 2014 amounted to \$97.3 million, which was relatively unchanged from the \$96.6 million recorded in 2013.

Total assets at December 31, 2014 amounted to \$3.2 billion, a 1.0% increase from a year earlier. Total loans at December 31, 2014 amounted to \$2.4 billion, a 2.7% decrease from a year earlier, and total deposits amounted to \$2.7 billion at December 31, 2014, a 2.0% decrease from a year earlier.



Investment securities totaled \$342.7 million at December 31, 2014 compared to \$227.0 million at December 31, 2013. In the fourth quarter of 2014, the Company used a portion of its excess cash balances to purchase approximately \$125 million in investment securities in order to earn higher yields.

Non-covered loans amounted to \$2.3 billion at December 31, 2014, an increase of \$15.7 million from December 31, 2013. The increase was due to the reclassification of \$39.7 million in loans from covered status to non-covered status in connection with the July 1, 2014 expiration of a loss sharing agreement – see discussion below. Loan growth was impacted by a relatively slow economic recovery in many of our market areas, as well as temporary pressures from new internal loan processes designed to enhance loan quality. Covered loans declined by \$82.7 million in 2014 due to the continued resolution of this portfolio and due to the reclassification discussed above.

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The lower amount of deposits at December 31, 2014 compared to December 31, 2013 was primarily due to declines in time deposits, with increases in checking accounts offsetting a large portion of the decline.

Other noteworthy events occurring in 2014 were:

As noted above, a loss-sharing agreement with the FDIC covering non-single family loans and foreclosed properties that were assumed in a failed bank acquisition in 2009 expired on July 1, 2014. We bear all future losses on these assets; however, at present, management does not expect such losses will be materially in excess of related loan loss allowances. The following presents information related to these assets as of July 1, 2014, which were transferred to the “non-covered” categories on that date.

|   |               |
|---|---------------|
| oLoans outstanding:                       | 39.7 million  |
| oNonaccrual loans:                        | \$9.7 million |
| oTroubled debt restructurings - accruing: | \$2.1 million |
| oAllowance for loan losses:               | \$1.7 million |
| oForeclosed properties:                   | \$3.0 million |

We continue to have three loss-sharing agreements with the FDIC in place. The next agreement that expires does so on April 1, 2016.

In December 2014, we completed the planned closure and consolidation of nine of our branches. All branches were consolidated with other branches near the closing location. We recorded approximately \$1.0 million in expense related to the branch consolidations.

**Outlook for 2016**

The interest rate environment remains challenging. Historically, the interest rates we charge loan customers are correlated with long-term interest rates in the marketplace. While the Federal Reserve increased short-term interest rates by 25 basis points in late 2015, long-term interest rates remain at historic lows. Additionally, interest rates on loans continue to be impacted downward by intense competition, and we expect continued declines in our loan discount accretion as our covered loan portfolios continue to wind down. Accordingly, we expect our overall loan yield to continue to decline. As it relates to our funding costs, the yields on many of our deposits are already very low and the ability to lower them further is limited. Accordingly, we believe that a continued compression of our net interest margin is likely.

With three consecutive years of significantly improved trends of nonperforming assets and lower loan charge-offs compared to the recession years, we recorded low levels of provisions for loan losses in 2015, which brought our overall allowance for loan loss level down to a more normalized level following the elevated amounts we maintained during and immediately following the recession. In 2016, we expect it is likely that we will record a higher provision for loan losses than we did in 2015, as we provide for on-going loan charge-offs and expected new loan growth.

Our local economies are generally improving, and we experienced solid loan and deposit growth in 2015. Additionally, over the past twelve months we have hired a number of experienced bankers who have brought us business, and we expect they will continue to do so. Accordingly, we expect to experience continued loan and deposit growth in 2016.

In late 2015 and early 2016, we began implementing plans to grow in larger and higher growth markets in North Carolina. It is likely the expected benefit to revenue and earnings will lag the initial and ongoing expense outlay as we develop business. However, we believe we will achieve growth in these new markets that will benefit our company in a long-term horizon.

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Consistent with the plan noted above and as previously discussed, in March 2016, we announced an agreement to exchange bank branches with another community bank that will result in our assumption of six bank branches in the Winston-Salem and Charlotte-metro markets of North Carolina, in return for our seven branches in southwestern Virginia.

## **Critical Accounting Policies**

The accounting principles we follow and our methods of applying these principles conform with accounting principles generally accepted in the United States of America and with general practices followed by the banking industry. Certain of these principles involve a significant amount of judgment and may involve the use of estimates based on our best assumptions at the time of the estimation. The allowance for loan losses, intangible assets, and the fair value and discount accretion of loans acquired in FDIC-assisted transactions

are three policies we have identified as being more sensitive in terms of judgments and estimates, taking into account their overall potential impact to our consolidated financial statements.

### Allowance for Loan Losses

Due to the estimation process and the potential materiality of the amounts involved, we have identified the accounting for the allowance for loan losses and the related provision for loan losses as an accounting policy critical to our consolidated financial statements. The provision for loan losses charged to operations is an amount sufficient to bring the allowance for loan losses to an estimated balance considered adequate to absorb losses inherent in the portfolio.

Our determination of the adequacy of the allowance is based primarily on a mathematical model that estimates the appropriate allowance for loan losses. This model has two components. The first component involves the estimation of losses on individually evaluated “impaired loans”. A loan is considered to be impaired when, based on current information and events, it is probable we will be unable to collect all amounts due according to the contractual terms of the loan agreement. A loan is specifically evaluated for an appropriate valuation allowance if the loan balance is above a prescribed evaluation threshold (which varies based on credit quality, accruing status, troubled debt restructured status, and type of collateral) and the loan is determined to be impaired. The estimated valuation allowance is the difference, if any, between the loan balance outstanding and the value of the impaired loan as determined by either 1) an estimate of the cash flows that we expect to receive from the borrower discounted at the loan’s effective rate, or 2) in the case of a collateral-dependent loan, the fair value of the collateral.

The second component of the allowance model is an estimate of losses for all loans not considered to be impaired loans (“general reserve loans”). General reserve loans are segregated into pools by loan type and risk grade and estimated loss percentages are assigned to each loan pool based on historical losses. The historical loss percentage is

then adjusted for any environmental factors used to reflect changes in the collectability of the portfolio not captured by historical data.

The reserves estimated for individually evaluated impaired loans are then added to the reserve estimated for general reserve loans. This becomes our “allocated allowance.” The allocated allowance is compared to the actual allowance for loan losses recorded on our books and any adjustment necessary for the recorded allowance to absorb losses inherent in the portfolio is recorded as a provision for loan losses. The provision for loan losses is a direct charge to earnings in the period recorded. Any remaining difference between the allocated allowance and the actual allowance for loan losses recorded on our books is our “unallocated allowance.”

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Loans covered under loss share agreements (referred to as “covered loans”) are recorded at fair value at acquisition date. Therefore, amounts deemed uncollectible at acquisition date become a part of the fair value calculation and are excluded from the allowance for loan losses. Subsequent decreases in the amount expected to be collected result in a provision for loan losses with a corresponding increase in the allowance for loan losses. Subsequent increases in the amount expected to be collected are accreted into income over the life of the loan. Proportional adjustments are also recorded to the FDIC indemnification asset.

Although we use the best information available to make evaluations, future material adjustments may be necessary if economic, operational, or other conditions change. In addition, various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses. Such agencies may require us to recognize additions to the allowance based on the examiners’ judgment about information available to them at the time of their examinations.

For further discussion, see “Nonperforming Assets” and “Summary of Loan Loss Experience” below.

## Intangible Assets

Due to the estimation process and the potential materiality of the amounts involved, we have also identified the accounting for intangible assets as an accounting policy critical to our consolidated financial statements.

When we complete an acquisition transaction, the excess of the purchase price over the amount by which the fair market value of assets acquired exceeds the fair market value of liabilities assumed represents an intangible asset. We must then determine the identifiable portions of the intangible asset, with any remaining amount classified as goodwill. Identifiable intangible assets associated with these acquisitions are generally amortized over the estimated life of the related asset, whereas goodwill is tested annually for impairment, but not systematically amortized. Assuming no goodwill impairment, it is beneficial to our future earnings to have a lower amount assigned to identifiable intangible assets and higher amount of goodwill as opposed to having a higher amount considered to be identifiable intangible assets and a lower amount classified as goodwill.

The primary identifiable intangible asset we typically record in connection with a whole bank or bank branch acquisition is the value of the core deposit intangible, whereas when we acquire an insurance agency, the primary identifiable intangible asset is the value of the acquired customer list. Determining the amount of identifiable intangible assets and their average lives involves multiple assumptions and estimates and is typically determined by performing a discounted cash flow analysis, which involves a combination of any or all of the following assumptions: customer attrition/runoff, alternative funding costs, deposit servicing costs, and discount rates. We typically engage a third party consultant to assist in each analysis. For the whole bank and bank branch transactions recorded to date, the core deposit intangibles have generally been estimated to have a life ranging from seven to ten years, with an

accelerated rate of amortization. For insurance agency acquisitions, the identifiable intangible assets related to the customer lists were determined to have a life of ten to fifteen years, with amortization occurring on a straight-line basis.

Subsequent to the initial recording of the identifiable intangible assets and goodwill, we amortize the identifiable intangible assets over their estimated average lives, as discussed above. In addition, on at least an annual basis, goodwill is evaluated for impairment by comparing the fair value of our reporting units to their related carrying value, including goodwill (our community banking operation is our only material reporting unit). If the carrying value of a reporting unit were ever to exceed its fair value, we would determine whether the implied fair value of the goodwill, using a discounted cash flow analysis, exceeded the carrying value of the goodwill. If the carrying value of the goodwill exceeded the implied fair value of the goodwill, an impairment loss would be recorded in an amount equal to that excess. Performing such a discounted cash flow analysis would involve the significant use of estimates and assumptions.

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In our 2015 goodwill impairment evaluation, we engaged a consulting firm that used various valuation techniques to assist us in concluding that our goodwill was not impaired.

We review identifiable intangible assets for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Our policy is that an impairment loss is recognized, equal to the difference between the asset's carrying amount and its fair value, if the sum of the expected undiscounted future cash flows is less than the carrying amount of the asset. Estimating future cash flows involves the use of multiple estimates and assumptions, such as those listed above.

## Fair Value and Discount Accretion of Loans Acquired in FDIC-Assisted Transactions

We consider the determination of the initial fair value of loans acquired in FDIC-assisted transactions, the initial fair value of the related FDIC indemnification asset, and the subsequent discount accretion of the purchased loans to involve a high degree of judgment and complexity. We determine fair value accounting estimates of newly assumed assets and liabilities in accordance with relevant accounting guidance. However, the amount that we realize on these assets could differ materially from the carrying value reflected in our financial statements, based upon the timing of collections on the acquired loans in future periods. To the extent the actual values realized for the acquired loans are different from the estimates, the FDIC indemnification asset will generally be impacted in an offsetting manner due to the loss-sharing support from the FDIC.

Because of the inherent credit losses associated with the acquired loans in a failed bank acquisition, the amount that we record as the fair values for the loans is generally less than the contractual unpaid principal balance due from the borrowers, with the difference being referred to as the "discount" on the acquired loans. We have applied the cost recovery method of accounting to all purchased impaired loans due to the uncertainty as to the timing of expected cash flows. This will generally result in the recognition of interest income on these impaired loans only when the cash payments received from the borrower exceed the recorded net book value of the related loans.

For nonimpaired purchased loans, we accrete the discount over the lives of the loans in a manner consistent with the guidance for accounting for loan origination fees and costs.

## **Merger and Acquisition Activity**

In 2013, we completed an acquisition of two branches with \$57 million in deposits and \$16 million in loans. In the 2013 acquisition, we purchased one of the branch buildings, while transferring the accounts of the other branch to an existing branch located nearby. The results of each acquired company/branch are included in our financial statements



beginning on their respective acquisition dates. We did not complete any acquisitions in 2014 or 2015. See Note 2 to the consolidated financial statements for additional information regarding these acquisitions.

As previously discussed, on January 1, 2016, we acquired an insurance agency in Sanford, North Carolina, and on March 4, 2016, we announced we had agreed to exchange our seven bank branches located in Virginia to another community bank in return for six of their branches.

### **FDIC Indemnification Asset**

As previously discussed, on June 19, 2009 and January 21, 2011, we acquired substantially all of the assets and liabilities of Cooperative Bank and The Bank of Asheville, respectively, in FDIC-assisted transactions. For each transaction, we entered into two loss share agreements with the FDIC, which provided First Bank significant loss protection from losses experienced on the loans and foreclosed real estate. Under the Cooperative Bank loss share agreements, the FDIC covers 80% of covered loan and foreclosed real estate losses up to \$303 million, and 95% of losses in excess of that amount. Under The Bank of Asheville loss share agreements, the FDIC covers 80% of all covered loan and foreclosed real estate losses. For both transactions, the loss share reimbursements are applicable for ten years for single family home loans and five years for all other loans. As previously discussed, one of the loss share agreements related to the Cooperative Bank acquisition expired on July 1, 2014.

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We recorded a FDIC indemnification asset related to the two transactions to account for payments that we expect to receive from the FDIC related to the loss share agreements. The carrying value of this receivable at each period end is the sum of: 1) actual claims that have been incurred and are in the process of submission to the FDIC for reimbursement, but have not yet been received and 2) our estimated amount of claimable loan and other real estate losses covered by the agreements multiplied by the FDIC reimbursement percentage.

At December 31, 2015 and 2014, the FDIC indemnification asset was comprised of the following components:

| (\$ in thousands)  | 2015     | 2014   |
|--|----------|--------|
| Receivable (payable) related to claims incurred (recoveries), not yet received (paid), net | \$(633 ) | 6,899  |
| Receivable related to estimated future claims on loans                                     | 8,675    | 14,933 |
| Receivable related to estimated future claims on foreclosed real estate                    | 397      | 737    |
| FDIC indemnification asset   | \$8,439  | 22,569 |

As of each acquisition date, based on the losses inherent in the covered assets and what we estimated we would receive as payments from the FDIC, we recorded a “FDIC Indemnification Asset.” Since that time, we have recorded adjustments to the indemnification asset as discussed below.

The FDIC indemnification asset has generally been adjusted in the following circumstances:

1) Deterioration of credit quality of covered loans – As of the acquisition dates, we recorded the loans acquired from Cooperative Bank and The Bank of Asheville on our books at a fair value that was \$227.9 million and \$51.7 million, respectively, less than the contractual amounts due from the borrowers, which was our estimate of the loan losses inherent in the portfolio. As the credit quality of these portfolios change and better information is obtained about likely losses, some loans have better repayment expectations than we originally projected and some loans have worse repayment expectations than originally projected. For loans with worse repayment expectations, we generally record provisions for loan losses with corresponding increases to the FDIC indemnification asset by recording noninterest income in proportion to the reimbursement percentage. In 2014 and 2013, we recorded total provisions for loan losses on covered loans amounting to \$3.1 million and \$12.4 million, respectively, which resulted in upward adjustments to the FDIC indemnification asset of \$1.4 million and \$9.6 million, respectively. We also record some provisions for loan losses without corresponding increases to the indemnification asset because we believe certain loan losses will occur after the expiration of the loss share agreements. In 2014 and 2013, we recorded provisions for loan losses on covered loans without a corresponding increase to the indemnification asset of \$1.4 million and \$0.3 million, respectively. In 2015, we recorded a negative provision for loan losses on covered loans amounting to \$2.8 million, which resulted in downward adjustments to the FDIC indemnification asset of \$2.2 million. The negative provision in 2015 was primarily the result of loan recoveries that exceeded charge-offs by \$2.3 million.

2) Write-downs and losses on foreclosed properties – When we foreclose on delinquent borrowers, we initially record the foreclosed property at the lower of book or fair value (based on current appraisals), with any deficiency recorded as a loan charge-off. Subsequent to the foreclosure, we periodically review the fair value of the property through updated appraisals or independent market pricing, and if the appraisal or market pricing indicates a fair value lower than our carrying value, we must write the property down. We also sell foreclosed properties that frequently result in losses. Each of these situations generally results in the Company recording losses on foreclosed properties with a corresponding increase to the FDIC indemnification asset by recording noninterest income in proportion to the reimbursement percentage. If we sell a foreclosed property that results in a gain, then we generally record a corresponding decrease to the FDIC indemnification asset to reflect the fact that we must reimburse the FDIC 80% of any gains that relate to prior claims. In 2015, we recorded net gains on covered foreclosed properties amounting to \$1.0 million, which resulted in a downward adjustment to the FDIC indemnification asset of \$0.4 million. In 2014, we recorded net losses and write-downs on covered foreclosed properties amounting to \$1.9 million, which resulted in an upward adjustment to the FDIC indemnification asset of \$1.5 million. In 2013, we recorded net gains on covered foreclosed properties amounting to \$0.4 million, which resulted in a downward adjustment to the FDIC indemnification asset of \$0.3 million.

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3) Expenses incurred related to collection activities on covered assets – As a result of our collection efforts, we incur expenses such as legal fees, property taxes and appraisal costs. Many of these expenses are reimbursable by the FDIC. These expenses are recorded as “other” noninterest expenses and a corresponding increase is made to increase the FDIC indemnification asset by reducing the gross collection expenses by the amount expected to be reimbursed by the FDIC for eligible expenses. In 2015, 2014, and 2013, we incurred \$1.2 million, \$3.1 million, and \$6.5 million, in gross collection expenses related to covered assets, respectively, and reduced that amount by \$1.2 million, \$3.9 million, and \$5.4 million in FDIC reimbursements, respectively.

4) Receipt of cash from the FDIC related to claims submitted – On at least a quarterly basis, we submit eligible loss share claims to the FDIC. After reviewing and approving the claims, the FDIC wires us cash, which reduces the amount of the FDIC indemnification asset. In 2015, 2014, and 2013, we received \$6.7 million, \$17.7 million, and \$49.6 million in FDIC reimbursements, respectively.

5) Accretion of discount on acquired loans – As noted above, we recorded the acquired loans of the two transactions on our books at a fair value that was \$280 million (in total) less than the contractual amounts due from the borrowers (the “discount”), which was our estimate of the loan losses inherent in the portfolio. As the credit quality of this portfolio changes and better information is obtained about likely losses, some loans have better repayment expectations than we originally projected and some loans have worse repayment expectations than originally projected (as discussed above). For loans with improved repayment expectations, we are systematically reducing the discount over the life of the loan. For some loans, we have received complete payoffs at the contractual balance and the discount must be reduced to zero. When we reduce/accrete the discount, we do so by recognizing interest income in that same amount. When the expected losses become less than the original estimate, our expected reimbursement from the FDIC declines as well. Accordingly, we generally reduce the FDIC indemnification asset in correlation to the accretion of the loan discount. In 2015, 2014, and 2013, we recorded discount accretion of \$4.8 million, \$16.0 million, and \$20.2 million, respectively, which resulted in reductions to the FDIC indemnification asset and indemnification expense of \$5.6 million, \$15.3 million, and \$16.2 million, respectively.

In summary, circumstances that result in adjustments to the FDIC indemnification asset are recorded within the income statement line items noted without consideration of the FDIC loss share agreements. Because favorable changes in covered assets result in lower expected FDIC claims, and unfavorable changes in covered assets generally result in higher expected FDIC claims, the FDIC indemnification asset is adjusted to reflect those expectations. The net increase or decrease in the indemnification asset is reflected within noninterest income.

The adjustments can result in volatility within individual income statement line items. Because of the FDIC loss share agreements and the associated indemnification asset, amounts recorded as provisions for loan losses, discount accretion, and losses from foreclosed properties generally only impact pretax income by 20% of those amounts, due to the corresponding adjustments made to the indemnification asset.

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The following presents a rollforward of the FDIC indemnification asset since the date of the Cooperative Bank acquisition on June 19, 2009 and includes additions related to The Bank of Asheville acquisition in 2011.

*(\$ in thousands)*

|  |           |
|--|-----------|
| Balance at June 19, 2009   | \$185,112 |
| Decrease related to favorable change in loss estimates                           | (1,516 )  |
| Increase related to reimbursable expenses  | 1,300     |
| Cash received  | (40,500 ) |
| Accretion of loan discount   | (1,175 )  |
| Balance at December 31, 2009   | 143,221   |
| Increase related to unfavorable change in loss estimates                         | 30,419    |
| Increase related to reimbursable expenses  | 2,900     |
| Cash received  | (46,721 ) |
| Accretion of loan discount   | (6,100 )  |
| Balance at December 31, 2010   | 123,719   |
| Increase related to acquisition of The Bank of Asheville                         | 42,218    |
| Increase related to unfavorable change in loss estimates                         | 29,814    |
| Increase related to reimbursable expenses  | 5,725     |
| Cash received  | (69,339 ) |
| Accretion of loan discount   | (9,278 )  |
| Other  | (1,182 )  |
| Balance at December 31, 2011   | 121,677   |
| Increase related to unfavorable change in loss estimates                         | 16,984    |
| Increase related to reimbursable expenses  | 6,947     |
| Cash received  | (29,796 ) |
| Accretion of loan discount   | (13,173 ) |
| Other  | (80 )     |
| Balance at December 31, 2012   | 102,559   |
| Increase related to unfavorable change in loss estimates                         | 9,312     |
| Increase related to reimbursable expenses  | 5,352     |
| Cash received  | (49,572 ) |
| Accretion of loan discount   | (16,160 ) |
| Other  | (2,869 )  |
| Balance at December 31, 2013   | 48,622    |
| Increase related to unfavorable change in loss estimates                         | 2,923     |
| Increase related to reimbursable expenses  | 3,925     |
| Cash received  | (17,724 ) |
| Accretion of loan discount   | (15,281 ) |
| Other  | 104       |
| Balance at December 31, 2014   | 22,569    |
| Increase (decrease) related to unfavorable (favorable) changes in loss estimates | (3,031 )  |
| Increase related to reimbursable expenses  | 1,232     |
| Cash received  | (6,673 )  |

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|   |          |
|---|----------|
| Accretion of loan discount                        | (5,584 ) |
| Decrease related to settlement of disputed claims | (406 )   |
| Other   | 332      |
| Balance at December 31, 2015                      | \$8,439  |

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The following table presents additional information regarding our covered loans, loan discounts, allowances for loan losses and the corresponding FDIC indemnification asset:

| <i>(\$ in thousands)</i>   | Cooperative<br>Single<br>Family<br>Loss Share<br>Loans | Bank of<br>Asheville<br>Single<br>Family<br>Loss Share<br>Loans | Bank of<br>Asheville<br>Non-Single<br>Family<br>Loss<br>Share<br>Loans |
|--|--|---|--|
| <b><u>At December 31, 2015</u></b>   |  |   |  |
| Expiration of loss share agreement   | 6/30/2019  | 3/31/2021   | 3/31/2016  |
| Nonaccrual covered loans   |  |   |  |
| Unpaid principal balance   | \$5,265  | 780   | 6,295  |
| Carrying value prior to loan discount*   | 5,104  | 610   | 4,276  |
| Loan discount  | 570  | 389   | 1,215  |
| Net carrying value   | 4,534  | 221   | 3,061  |
| Allowance for loan losses  | 251  | 6   | 171  |
| Indemnification asset recorded   | 511  | 232   | 245  |
| All other covered loans  |  |   |  |
| Unpaid principal balance   | 85,824   | 6,458   | 15,860   |
| Carrying value prior to loan discount*   | 85,685   | 6,379   | 15,847   |
| Loan discount  | 11,528   | 1,099   | 459  |
| Net carrying value   | 74,157   | 5,280   | 15,388   |
| Allowance for loan losses  | 1,092  | 55  | 224  |
| Indemnification asset recorded   | 6,815  | 804   | 77   |
| All covered loans  |  |   |  |
| Unpaid principal balance   | 91,089   | 7,238   | 22,155   |
| Carrying value prior to loan discount*   | 90,789   | 6,989   | 20,123   |
| Loan discount  | 12,098   | 1,488   | 1,674  |
| Net carrying value   | 78,691   | 5,501   | 18,449   |
| Allowance for loan losses  | 1,343  | 61  | 395  |
| Indemnification asset recorded   | 7,326  | 1,036   | 322  |
| Foreclosed Properties  |  |   |  |
| Net carrying value   | 512  | —   | 294  |
| Indemnification asset recorded   | 365  | —   | 32   |
| For the Year Ended December 31, 2015   |  |   |  |
| Loan discount accretion recognized   | 1,969  | 812   | 1,970  |
| Indemnification asset expense associated with the loan discount accretion recognized | 2,848  | 680   | 2,056  |

\* Reflects partial charge-offs

\*\* A present value adjustment of \$9 reduces the carrying value of this asset to \$8,675

Our loss share agreement related to Cooperative Bank's non-single family assets expired on June 30, 2014. On July 1, 2014, the remaining balances associated with the Cooperative non-single family loans and foreclosed properties were transferred from the covered portfolio to the non-covered portfolio. We bear all future losses on this portfolio of loans and foreclosed properties. Immediately prior to the transfer, this portfolio of loans had a carrying value of \$39.7 million and the portfolio of foreclosed properties had a carrying value of \$3.0 million, and both portfolios were classified as covered. Of the \$39.7 million in loans that lost loss share protection, approximately \$9.7 million of these loans were on nonaccrual status and \$2.1 million of these loans were classified as accruing troubled debt restructurings as of July 1, 2014. Additionally, approximately \$1.7 million in allowance for loan losses that related to this portfolio of loans was transferred to the allowance for loan losses for non-covered loans on July 1, 2014. As of July 1, 2014, there was no remaining loan discount or indemnification asset related to the Cooperative non-single family loss share loans or foreclosed properties.

As noted in the table above, our loss share agreement related to Bank of Asheville's non-single family assets expires in March 2016. We continue to make progress in winding down this portfolio, and we do not currently expect its expiration will have a material impact on our Company.



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Loan discount accretion and corresponding indemnification asset expense continue to be recorded on the three portfolios covered by loss share agreements. Because of the continued decline in the amount of remaining unaccreted discount, the amount of loan discount accretion and corresponding indemnification asset expense is expected to continue to decline in future periods.

**ANALYSIS OF RESULTS OF OPERATIONS**

Net interest income, the “spread” between earnings on interest-earning assets and the interest paid on interest-bearing liabilities, constitutes the largest source of our earnings. Other factors that significantly affect operating results are the provision for loan losses, noninterest income such as service fees and noninterest expenses such as salaries, occupancy expense, equipment expense and other overhead costs, as well as the effects of income taxes.

**Net Interest Income**

Net interest income on a reported basis amounted to \$119.7 million in 2015, \$131.6 million in 2014, and \$136.5 million in 2013. For internal purposes and in the discussion that follows, we evaluate our net interest income on a tax-equivalent basis by adding the tax benefit realized from tax-exempt securities to reported interest income. Net interest income on a tax-equivalent basis amounted to \$121.4 million in 2015, \$133.1 million in 2014, and \$138.0 million in 2013. Management believes that analysis of net interest income on a tax-equivalent basis is useful and appropriate because it allows a comparison of net interest amounts in different periods without taking into account the different mix of taxable versus non-taxable investments that may have existed during those periods. The following is a reconciliation of reported net interest income to tax-equivalent net interest income.

| (\$ in thousands)                   | Year ended December 31, |         |         |
|-------------------------------------|-------------------------|---------|---------|
|                                     | 2015                    | 2014    | 2013    |
| Net interest income, as reported    | \$119,747               | 131,609 | 136,526 |
| Tax-equivalent adjustment           | 1,634                   | 1,502   | 1,511   |
| Net interest income, tax-equivalent | \$121,381               | 133,111 | 138,037 |

Table 2 analyzes net interest income on a tax-equivalent basis. Our net interest income on a tax-equivalent basis decreased by 8.8% in 2015 and decreased by 3.6% in 2014. There are two primary factors that cause changes in the amount of net interest income we record - 1) our net interest margin (tax-equivalent net interest income divided by average interest-earning assets), and 2) changes in our loans and deposits balances.

The decreases in net interest income in 2015 and 2014 were primarily due to decreases in our net interest margin during 2015 and 2014. “Net interest margin” is a ratio we use to measure the spread between the yield on our earning

assets and the cost of our funding and is calculated by taking tax-equivalent net interest income and dividing by average earning assets. Our net interest margin decreased from 4.92% in 2013 to 4.58% in 2014 to 4.13% in 2015.

Lower asset yields have been the primary factor causing the decline in the net interest margin. From 2013 to 2015, the yield we earned on our interest-earning assets declined from 5.31% in 2013 to 4.86% in 2014 to 4.37% in 2015. The biggest factor causing our lower net interest margin in 2015 compared to 2014 was lower discount accretion on loans purchased in failed bank acquisitions (see discussion below). Additionally, for the past several years, the interest rate environment has remained at low levels with maturing assets originated in prior periods generally repricing at progressively lower interest rates at renewal/maturity. Also impacting the decline in 2014 was our decision, in anticipation of higher loan growth and expectation of higher interest rates, to maintain a higher mix of our earnings assets in liquid cash accounts that earned relatively little interest. Late in the fourth quarter of 2014, in order to improve yields and in expectation that interest rate increases were further off than originally projected, we elected to invest a portion of our excess cash. Accordingly we purchased approximately \$125 million of investment securities, which helped lessen the impact of lower loan yields in 2015.

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The declines in asset yields were partially offset by lower liability costs. We have been able to lower interest rates on maturing time deposits that were originated in prior periods, and we have also been able to progressively lower interest rates on various types of interest-bearing checking, savings, and money market accounts. The average interest rate paid on our interest bearing deposits declined from 0.43% in 2013 to 0.32% in 2014 to 0.26% in 2015. Also, the funding mix of our liabilities had a positive impact on our net interest margin. As calculated from Table 2, the average amount of our lower cost deposits, comprised of checking accounts (non-interest bearing and interest bearing), money market accounts and savings accounts, steadily increased from \$1.7 billion in 2013 to \$2.0 billion in 2015, an increase of 15%, while the average amount of our higher cost funding, comprised of time deposits and borrowings, decreased from \$1.1 billion to \$0.9 billion over that same period, a decline of 21%.

The net interest margin for all periods benefited, by varying amounts, from the net accretion of purchase accounting premiums/discounts associated with the Cooperative Bank acquisition in June 2009 and, to a lesser degree, The Bank of Asheville acquisition in January 2011. As can be seen in the table below, we recorded \$4.8 million in 2015, \$15.9 million in 2014, and \$19.8 million in 2013, in net accretion of purchase accounting premiums/discounts that increased net interest income.

| (\$ in thousands)  | Year Ended<br>December 31,<br>2015 | Year Ended<br>December 31,<br>2014 | Year Ended<br>December 31,<br>2013 |
|--|------------------------------------|------------------------------------|------------------------------------|
| Interest income – reduced by premium amortization on loans     | \$ —                               | (98                                | ) (386                             |
| Interest income – increased by accretion of loan discount      | 4,751                              | 16,009                             | 20,200                             |
| Interest expense – reduced by premium amortization of deposits | —                                  | 7                                  | 29                                 |
| Impact on net interest income                                  | \$ 4,751                           | 15,918                             | 19,843                             |

The biggest component of the purchase accounting adjustments in each year was loan discount accretion, which amounted to \$4.8 million in 2015, \$16.0 million in 2014, and \$20.2 million in 2013. In 2015 and 2014, lower amounts of remaining unaccreted loan discount resulted in lower amounts of loan discount accretion – unaccreted loan discount amounted to \$15 million, \$21 million, and \$40 million at December 31, 2015, 2014 and 2013, respectively. We expect loan discount accretion to continue to decline as a result of the continued decline in remaining unaccreted discount.

Table 3 presents additional detail regarding the estimated impact that changes in loan and deposit volumes and changes in the interest rates we earned/paid had on our net interest income in 2014 and 2015. For both years, changes in interest rates was the primary factor affecting net interest income. Table 3 indicates that in 2015, changes in interest rates reduced interest income by \$15.3 million, while interest expense was only reduced by \$0.7 million due to rates. Thus, the disparate impact of lower interest rates was the primary reason that net interest income decreased by \$11.7 million during the year. Similarly in 2014, the impact of the lower rates reduced interest income by \$8.7 million, while interest expense was only reduced by \$2.7 million due to rates. Thus, lower interest rates were the primary reason that net interest income decreased by \$4.9 million during the year.

See additional information regarding net interest income in the section entitled “Interest Rate Risk.”

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**Provision for Loan Losses**

The provision for loan losses charged to operations is an amount sufficient to bring the allowance for loan losses to an estimated balance considered appropriate to absorb probable losses inherent in our loan portfolio. Management's determination of the adequacy of the allowance is based on our level of loan growth, an evaluation of the loan portfolio, current economic conditions, historical loan loss experience and other risk factors.

For 2015, we recorded total negative provisions for loan losses (reduction of allowance for loan losses) of \$0.8 million. For 2014 and 2013, our total provisions for loan losses were \$10.2 million and \$30.6 million, respectively. The total provision for loan losses is comprised of provision for loan losses for non-covered loans and provision for loan losses for covered loans, as discussed in the following paragraphs.

We recorded \$2.0 million, \$7.1 million, and \$18.3 million in provisions for loan losses related to non-covered loans for the years ended December 31, 2015, 2014, and 2013, respectively. The lower provision in 2015 compared to 2014 was primarily the result of stable asset quality trends. Non-covered loan growth for 2015 was \$148 million compared to a decline of \$24 million in 2014, which resulted in a larger incremental provision for the loan losses attributable to loan growth. However, offsetting this larger incremental provision were favorable trends in our asset quality. Our non-covered classified and nonaccrual loans decreased from \$125.4 million at December 31, 2014 to \$101.9 million at December 31, 2015. Additionally, our allowance for loan loss model, which dictates the provisions for loan losses that we record, utilizes the net charge-offs experienced in the most recent years as a significant component of estimating the current allowance for loan losses that is necessary. Thus, older years (and parts thereof) systematically age out and are excluded from the analysis as time goes on. The final periods of high net charge-offs we experienced during the peak of the recession dropped out of the analysis in 2015 and were replaced by the more modest levels of net charge-offs recently experienced. The fourth quarter of 2015 marked our twelfth consecutive quarter of annualized net charge-offs related to non-covered loans being less than 1.00%, whereas at the peak of the recession, that ratio was frequently over 1.00%. Accordingly, the relatively low provision recorded in 2015 resulted in our non-covered allowance for loan loss declining to a more normalized level following the elevated amounts we maintained during and immediately following the recession. In 2016, it is likely that we will record a higher amount of provision for loan losses than we did in 2015, as we provide for on-going loan charge-offs and expected new loan growth.

The same general factors discussed above that resulted in a lower provision for loan losses in 2015 also resulted in the provision for loan losses being lower in 2014 compared to 2013.

As it relates to covered loans, we recorded a negative provision for loan losses (reduction of allowance for loan losses) of \$2.8 million in 2015. The negative provision resulted from lower levels of covered nonperforming loans, declining levels of total covered loans, and several large recoveries received that resulted in having net loan recoveries (recoveries, net of charge-offs) of \$2.3 million for 2015.

We recorded provisions for loan losses on covered loans of \$3.1 million and \$12.4 million during 2014 and 2013, respectively. These provisions were necessary to provide for loans that showed signs of collection problems during the respective periods, as well as to provide for collateral dependent nonaccrual loans for which we received updated appraisals during the year that reflected lower collateral valuations. The decline in the provision for loan losses on covered loans from 2013 to 2014 was primarily due to lower levels of covered nonperforming loans during the period and stabilization in the underlying collateral values of nonperforming loans. Because of the FDIC loss share agreements in place for these loans, the FDIC indemnification asset was adjusted upwards as a result of claimable losses associated with these loans.

Total net charge-offs (covered and non-covered) for the years ended December 31, 2015, 2014, and 2013, were \$11.3 million, \$18.1 million, and \$28.5 million, respectively.

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Net-charge offs of non-covered loans were \$13.6 million, \$14.7 million, and \$15.6 million for 2015, 2014, and 2013, respectively. The ratio of net charge-offs to average non-covered loans was 0.58%, 0.65%, and 0.72% for 2015, 2014, and 2013, respectively. The declining amount of non-covered net-charge offs in recent years is reflective of improving economic conditions and lower levels of our highest-risk loans.

Net charge-offs (recoveries) of covered loans were (\$2.3 million), \$3.3 million and \$12.9 million in 2015, 2014, and 2013, respectively. During 2015, we realized covered recoveries of \$3.6 million, which more than offset our gross charge-offs of \$1.3 million. In 2014 we realized a recovery of \$1.9 million related to a covered loan that was the subject of a significant charge-off in 2013, which reduced net charge-offs for 2014. The lower levels of net charge-offs is also reflective of lower amounts of nonperforming covered loans.

As seen in Tables 14 and 14a, in 2015, net charge-offs were highest in the loans classified as “real estate – mortgage – residential (1-4 family) first mortgages.” Charge-offs of residential first mortgage loans reflect continued challenging economic conditions in some of our more rural market areas. In 2014 and 2013, net charge-offs were highest in loans classified as “real estate – construction, land development & other land loans.” This category of loans is primarily comprised of land acquisition and development loans and other types of lot loans. These types of loans were particularly hard hit by the decline in real estate development and property values that occurred in the recession.

See “Nonperforming Assets” below for further discussion of our asset quality, which impacts our provisions for loan losses.

See the section entitled “Allowance for Loan Losses and Loan Loss Experience” below for a more detailed discussion of the allowance for loan losses. The allowance is monitored and analyzed regularly in conjunction with our loan analysis and grading program, and adjustments are made to maintain an adequate allowance for loan losses.

## **Noninterest Income**

Our noninterest income amounted to \$18.8 million in 2015, \$14.4 million in 2014, and \$23.5 million in 2013.

As shown in Table 4, core noninterest income excludes gains from acquisitions, foreclosed property write-downs and losses, indemnification asset income (expense), securities gains or losses, and other miscellaneous gains and losses. Core noninterest income amounted to \$29.3 million in 2015, a 3.8% decrease from the \$30.5 million recorded in 2014. The 2014 core noninterest income of \$30.5 million was 8.0% higher than the \$28.2 million recorded in 2013.

See Table 4 and the following discussion for an understanding of the components of noninterest income.

Service charges on deposit accounts amounted to \$11.6 million, \$13.7 million, and \$12.8 million in 2015, 2014 and 2013, respectively. After the elimination of free checking for most customers with low balances in late 2013 which resulted in a strong increase in service charges in the first half of 2014, monthly fees earned on deposit accounts gradually declined thereafter as a result of more customers meeting the requirements to have the monthly service charge waived. Fewer instances of fees earned from customers overdrawing their accounts also impacted this line item in 2015.

Other service charges, commissions and fees amounted to \$10.9 million in 2015, an 8.9% increase from the \$10.0 million earned in 2014. The 2014 amount of \$10.0 million was 7.5% higher than the \$9.3 million earned in 2013. This category of noninterest income includes items such as electronic payment processing revenue (which includes fees related to credit card transactions by merchants and customers and fees earned from debit card transactions), ATM charges, safety deposit box rentals, fees from sales of personalized checks, and check cashing fees. The growth in this category for both years was primarily attributable to increased debit card usage by our customers, as we earn a small fee each time our customers make a debit card transaction. Interchange income from credit cards has also increased due to growth in the number and usage of credit cards, which we believe is a result of increased promotion of this product.



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Fees from presold mortgages amounted to \$2.5 million in 2015, \$2.7 million in 2014, and \$2.9 million in 2013. Lower refinancing activity resulted in slight decreases in these fees in 2015 and 2014. Also, a portion of the decline in 2015 was due to our decision to hold more loans for investment in 2015 compared to 2014 in order to offset declines in our residential mortgage loan portfolio.

Commissions from sales of insurance and financial products amounted to \$2.6 million in 2015, \$2.7 million in 2014, and \$2.1 million in 2013. This line item includes commissions we receive from three sources - 1) sales of credit life insurance associated with new loans, 2) commissions from the sales of investment, annuity, and long-term care insurance products, and 3) commissions from the sale of property and casualty insurance. The following table presents the contribution of each of the three sources to the total amount recognized in this line item:

| (\$ in thousands)   | For the year ended December 31, |       |       |
|---|---------------------------------|-------|-------|
|   | 2015                            | 2014  | 2013  |
| Commissions earned from:                                      |                                 |       |       |
| Sales of credit life insurance                                | \$ 26                           | 43    | 58    |
| Sales of investments, annuities, and long term care insurance | 1,934                           | 2,028 | 1,353 |
| Sales of property and casualty insurance                      | 620                             | 662   | 721   |
| Total   | \$ 2,580                        | 2,733 | 2,132 |

As can be seen in the above table, sales of investments, annuities and long term care insurance declined slightly in 2015 compared to 2014 resulting from lower commissions earned on sales of investments. The increase from 2013 to 2014 was the result of hiring more employees in our investment division in the years leading up to 2014.

Table 4 shows earnings from bank owned life insurance income were \$1.7 million in 2015, \$1.3 million in 2014, and \$1.1 million in 2013. In 2015, 2014, and 2013, we purchased \$15.0 million, \$10.0 million, and \$15.0 million, respectively, in bank-owned life insurance on certain officers of our company, which increased our income for this line item.

Noninterest income not considered to be “core” resulted in net reductions to total noninterest income of \$10.6 million in 2015, \$16.1 million in 2014, and \$4.7 million in 2013. The components of non-core noninterest income are shown in Table 4 and the significant components thereof are discussed below.

We recorded net losses on non-covered foreclosed properties of \$2.5 million in 2015 and \$1.9 million in 2014 compared to net gains of \$1.3 million in 2013. In 2015 and 2014, in order to dispose of certain of our foreclosed properties that we had held for an extended period of time, it became necessary to accept sales offers that resulted in losses. In 2013, we experienced miscellaneous gains from sales of properties following stabilization in real estate

market values and lower carrying values following significant write-downs recorded in 2012.

We recorded \$1.0 million of net gains on covered foreclosed properties in 2015, \$1.9 million of net losses on covered foreclosed properties in 2014, and \$0.4 million of net gains on covered foreclosed properties in 2013. Gains and losses on covered foreclosed properties have generally been lower in recent years than in the years immediately following our failed bank acquisitions, as we are holding significantly lower levels of covered foreclosed properties and real estate prices have stabilized. As discussed earlier and illustrated in the table below, when gains or losses are realized on covered foreclosed properties, there is generally a corresponding entry to indemnification asset income (expense) amounting to 80% of the losses (gains) recorded.

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Indemnification asset expense amounted to \$8.6 million, \$12.8 million, and \$6.8 million, for the three years ended December 31, 2015, respectively. Indemnification asset income (expense) is recorded to reflect additional (decreased) amounts expected to be received from the FDIC during the period related to covered assets. The three primary items that result in recording indemnification asset income (expense) are 1) loan discount accretion resulting from improved borrower repayment prospects, which generally results in indemnification expense, 2) provisions (reversals) for loan losses on covered loans, which result in indemnification income (expense) and 3) foreclosed property gains (losses) on covered assets, which result in indemnification expense related to gains and indemnification income related to losses. The lower indemnification asset expense in 2015 is primarily correlated with significantly lower loan discount accretion income recorded in 2015. The higher indemnification asset expense in 2014 is primarily related to fewer loan losses, which resulted in lower indemnification income to offset the other sources of indemnification expense. The following table presents the sources of indemnification income (expense) for the periods noted.

| (\$ in millions)  | For the year ended |         |         |
|---|--------------------|---------|---------|
|   | December 31,       |         |         |
|   | 2015               | 2014    | 2013    |
| Indemnification asset expense associated with loan discount accretion income              | \$ (5.6 )          | (15.3 ) | (16.2 ) |
| Indemnification asset income (expense) associated with loan losses (recoveries), net      | (2.3 )             | 1.4     | 9.6     |
| Indemnification asset income (expense) associated with foreclosed property losses (gains) | (0.4 )             | 1.5     | (0.3 )  |
| Other sources of indemnification asset income (expense)                                   | (0.3 )             | (0.4 )  | 0.1     |
| Total indemnification asset income (expense)  | \$ (8.6 )          | (12.8 ) | (6.8 )  |

Securities gains (losses) were insignificant for 2015. We recorded \$0.8 million and \$0.5 million in securities gains during 2014 and 2013, respectively, related to sales of \$47.5 million and \$12.9 million in available for sale securities, respectively.

The line item “Other gains (losses)” was negatively impacted in 2015 by a \$0.4 million write-off of a FDIC claim associated with a dispute settlement (see Note 6 of the consolidated financial statements for additional discussion), whereas in 2014, the net loss included losses on sales of vacated branch buildings. The amount for 2013 was insignificant.

**Noninterest Expenses**

Total noninterest expenses totaled \$98.1 million, \$97.3 million, and \$96.6 million for 2015, 2014 and 2013, respectively. Table 5 presents the components of our noninterest expense during the past three years. Line items with the largest fluctuations are discussed below.

Total personnel expense increased from \$55.2 million in 2014 to \$56.8 million in 2015, an increase of \$1.6 million, or 3.0%. Within personnel expense, salaries expense increased \$1.6 million, of which \$0.9 million related to higher

amounts of incentive compensation expense earned by employees in 2015. Also, we recorded \$0.6 million in stock-based compensation expense in 2015 compared to \$0.1 million in 2014, primarily related to retention-based stock grants made in 2015. Employee benefits expense for 2015 remained unchanged from 2014 at \$9.1 million.

In comparing 2014 to 2013, total personnel expense increased from \$54.8 million in 2013 to \$55.2 million in 2014, an increase of \$0.4 million, or 0.7%. Within personnel expense, salaries expense increased \$1.0 million, which relates to higher amounts of incentive compensation as a result of higher earnings in 2014, as well as lower amounts of salary expense deferred and recognized as a loan yield adjustment, as a result of fewer new loan originations. The increase in salaries expense in 2014 was largely offset by a decrease in employee benefits expense. Employee benefits expense decreased by \$0.6 million, or 5.8%, in comparing 2014 to 2013, which is primarily attributable to the pension income we recorded in 2014 related to investment income from our pension plan's assets. Pension income for the year ended December 31, 2014 was \$1.1 million in comparison to pension income of \$0.6 million recorded in 2013.

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Net occupancy expenses have remained relatively stable over the past three years, amounting to \$7.4 million in 2015, \$7.4 million in 2014, and \$7.1 million in 2013.

Equipment related expenses were \$3.7 million, \$3.9 million, and \$4.4 million, in 2015, 2014, and 2013, respectively. During the fourth quarter of 2013, we outsourced certain data processing activities to a third-party provider, which resulted in a reduction in depreciation expense and machine maintenance expense associated with the computer equipment and software that is no longer being used for data processing.

FDIC insurance expense amounted to \$2.4 million in 2015, \$4.0 million in 2014, and \$2.8 million in 2013. The insurance premium rate charged by the FDIC is based on several variable factors that can result in fluctuations from year to year.

Collection expenses related to non-covered assets have remained relatively unchanged over the past three years, amounting to \$2.2 million in 2015, \$2.1 million in 2014, and \$2.2 million in 2013.

Collection expenses on covered assets, net of FDIC reimbursements, amounted to a net reimbursement of \$0.1 million in 2015, a net reimbursement of \$0.9 million in 2014 and expense of \$1.1 million in 2013. This expense has generally declined in recent years due to the declining levels of covered nonperforming assets. Additionally, in the fourth quarter of 2014, we determined that approximately \$1.0 million in collection expenses incurred in prior years associated with covered assets were eligible to be claimed for reimbursement with the FDIC. We expect collection expenses on covered assets, net of FDIC reimbursements, to be minimal in 2016.

Telephone and data line expense amounted to \$2.1 million in 2015 and \$2.0 million in 2014, compared to \$1.5 million in 2013. The higher levels in 2014 and 2015 compared to 2013 were due to costs associated with upgrades in the quality of our data lines at many of our branches.

As discussed above, in December 2013 we began outsourcing our core data processing to a large, reputable processor. We previously processed our data in-house, and expenses related to these activities were included in various line items of our Consolidated Statements of Income. We recorded \$1.7 million in data processing expense in 2014 and \$1.9 million in 2015 compared to none in 2013.

Legal and audit expense amounted to \$1.7 million in 2015 and \$2.0 million in 2014, compared to \$1.2 million in 2013. The increase from 2013 to 2014 is primarily a result of our decision to outsource the internal audit function in late 2013.

Outside consultant expense was \$1.7 million in each of 2015 and 2014 compared to \$2.5 million in 2013. An efficiency project using outside consultants that began in 2012 wound down in 2014, which resulted in a decline in this line item in 2014.

In 2014, we also recorded \$1.0 million in expenses related to the consolidation and closure of nine of our branches. The branches that were consolidated were generally smaller in size with relatively low staff counts.

We recorded \$0.2 million and \$0.5 million in severance expenses in 2015 and 2014, respectively. In 2013, we recorded \$1.9 million in severance expenses due primarily to the separation from service of our former chief executive officer.

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**Income Taxes**

Table 6 presents the components of income tax expense and the related effective tax rates. We recorded income tax expense of \$14.1 million in 2015, \$13.5 million in 2014, and \$12.1 million in 2013. Our effective tax rates was 34.3% for 2015, 35.1% for 2014 and 36.9% for 2013. The progressively lower effective tax rate has been due to higher amounts of tax-exempt income, primarily bank-owned life insurance income, and lower statutory income tax rates in North Carolina. Effective January 1, 2014, North Carolina implemented decreases to its state income tax rate for corporations from 6.9% in 2013 to 6.0% in 2014 to 5.0% in 2015. The North Carolina state income tax rate further declines to 4% in 2016, and thus we expect our effective tax rate will decline to approximately 34.0% in 2016. Our effective tax rate in 2013 was unfavorably impacted by the change in the North Carolina state tax rates, as we recorded incremental tax expense of \$0.5 million to reduce the value of our deferred tax asset due to the lower future rates.

**Stock-Based Compensation**

We recorded stock-based compensation expense of \$0.7 million, \$0.3 million, and \$0.2 million for the years ended December 31, 2015, 2014, and 2013, respectively. The higher expense in 2015 was due to retention-based restricted stock grants made to certain officers during the year. See Note 15 to the consolidated financial statements for more information regarding stock-based compensation.

Table of Contents**ANALYSIS OF FINANCIAL CONDITION AND CHANGES IN FINANCIAL CONDITION****Overview**

At December 31, 2015, our total assets amounted to \$3.4 billion, a 4.5% increase from 2014. The following table presents detailed information regarding the nature of changes in our loans and deposits in 2014 and 2015:

| (\$ in thousands)                    | Balance at beginning of period | Internal growth, net (1) | Growth from Acquisitions | Transfer due to Expiration of Loss Share Agreement | Balance at end of period | Total percentage growth | Internal percentage growth (1) |
|--------------------------------------|--------------------------------|--------------------------|--------------------------|--|--------------------------|-------------------------|--------------------------------|
| <b>2015</b>                          |                                |                          |                          |  |                          |                         |                                |
| Loans – Non-covered                  | \$2,268,580                    | 147,705                  | —                        | —  | 2,416,285                | 6.5%                    | 6.5%                           |
| Loans – Covered                      | 127,594                        | (24,953 )                | —                        | —  | 102,641                  | -19.6%                  | -19.6%                         |
| Total loans                          | 2,396,174                      | 122,752                  | —                        | —  | 2,518,926                | 5.1%                    | 5.1%                           |
| Deposits – Noninterest-bearing       | 560,230                        | 98,808                   | —                        | —  | 659,038                  | 17.6%                   | 17.6%                          |
| Deposits – Interest-bearing checking | 583,903                        | 42,975                   | —                        | —  | 626,878                  | 7.4%                    | 7.4%                           |
| Deposits – Money market              | 548,255                        | 88,437                   | —                        | —  | 636,692                  | 16.1%                   | 16.1%                          |
| Deposits – Savings                   | 180,317                        | 6,299                    | —                        | —  | 186,616                  | 3.5%                    | 3.5%                           |
| Deposits – Brokered time             | 88,375                         | (11,963 )                | —                        | —  | 76,412                   | -13.5%                  | -13.5%                         |
| Deposits – Internet time             | 747                            | (747 )                   | —                        | —  | —                        | -100.0%                 | -100.0%                        |
| Deposits – Time >\$100,000 – retail  | 384,127                        | (54,308 )                | —                        | —  | 329,819                  | -14.1%                  | -14.1%                         |
| Deposits – Time <\$100,000 – retail  | 349,952                        | (54,122 )                | —                        | —  | 295,830                  | -15.5%                  | -15.5%                         |
| Total deposits                       | \$2,695,906                    | 115,379                  | —                        | —  | 2,811,285                | 4.3%                    | 4.3%                           |
| <b>2014</b>                          |                                |                          |                          |  |                          |                         |                                |
| Loans – Non-covered                  | \$2,252,885                    | (23,978 )                | —                        | 39,673   | 2,268,580                | 0.7%                    | -1.1%                          |
| Loans – Covered                      | 210,309                        | (43,042 )                | —                        | (39,673 )  | 127,594                  | -39.3%                  | -20.5%                         |
| Total loans                          | 2,463,194                      | (67,020 )                | —                        | —  | 2,396,174                | -2.7%                   | -2.7%                          |
| Deposits – Noninterest-bearing       | 482,650                        | 77,580                   | —                        | —  | 560,230                  | 16.1%                   | 16.1%                          |
| Deposits – Interest-bearing checking | 557,413                        | 26,490                   | —                        | —  | 583,903                  | 4.8%                    | 4.8%                           |
| Deposits – Money market              | 547,556                        | 699                      | —                        | —  | 548,255                  | 0.1%                    | 0.1%                           |
| Deposits – Savings                   | 169,023                        | 11,294                   | —                        | —  | 180,317                  | 6.7%                    | 6.7%                           |
| Deposits – Brokered time             | 116,087                        | (27,712 )                | —                        | —  | 88,375                   | -23.9%                  | -23.9%                         |
| Deposits – Internet time             | 1,319                          | (572 )                   | —                        | —  | 747                      | -43.4%                  | -43.4%                         |
| Deposits – Time >\$100,000 – retail  | 451,741                        | (67,614 )                | —                        | —  | 384,127                  | -15.0%                  | -15.0%                         |
| Deposits – Time <\$100,000 – retail  | 425,230                        | (75,278 )                | —                        | —  | 349,952                  | -17.7%                  | -17.7%                         |
| Total deposits                       | \$2,751,019                    | (55,113 )                | —                        | —  | 2,695,906                | -2.0%                   | -2.0%                          |



(1) Excludes the impact of the transfer of loans from covered status to non-covered status on July 1, 2014 due to the expiration of one of our loss-sharing agreements, but includes growth or declines in these loans after date of transfer. Also, excludes the impact of acquisitions in the year of acquisition, but includes growth or declines in acquired operations after the date of acquisition.

In 2015, as derived from the table above, our total loans increased by \$123 million, or 5.1%. During that period, we experienced internal growth in our non-covered loan portfolio of \$148 million, or 6.5%, while our covered loans declined by \$25 million, or 19.6%. We expect continued growth in our non-covered loan portfolio in 2016, as we have recently expanded into higher growth market areas, and we had experienced bankers join our company over the past twelve months. We expect our covered loans to continue to decline as a result of normal pay-downs, foreclosures, and charge-offs.

In 2014, as derived from the table above, our total loans decreased by \$67 million, or 2.7%. The increase in the ending balance of our non-covered loan portfolio was due to the transfer of \$39.7 million of loans from covered status to non-covered status on July 1, 2014 upon the scheduled expiration of one of our loss-sharing agreements on June 30, 2014. Excluding that transfer, we experienced a net decline in our non-covered loan portfolio of \$24 million, or 1.1%, which we believe was due to slow economic recovery in many of the our market areas, as well as temporary pressures from new internal loan processes that we implemented in 2014 designed to enhance loan quality. Covered loans declined by \$82.7 million during 2014, with approximately half of the decline due to the aforementioned transfer of loans to non-covered status and the other half as a result of normal pay-downs, foreclosures, and charge-offs.

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During 2015, we experienced a net increase in total deposits of \$115.4 million, or 4.3%, which resulted from significant growth in our low-cost core deposit accounts (checking, money market and savings) offsetting declines in our time deposit accounts. We experienced growth of \$236.5 million in our core deposit accounts, compared to declines of \$121.1 million in time deposits. As previously discussed, our net interest margin benefited from this shift.

During 2014, we experienced a net decline in total deposits of \$55.1 million. Growth of \$116 million in our core deposit accounts was more than offset by a \$171 million decline in time deposits. With the low loan growth experienced in 2014, we were able to maintain pricing discipline on our rate sensitive deposits, which resulted in the loss of some of those balances.

Our overall liquidity decreased slightly in 2015 compared to 2014, primarily as a result of loan growth and the redemption of \$63.5 million of our SBLF preferred stock. Our liquid assets (cash and securities) as a percentage of our total deposits and borrowings decreased from 21.2% at December 31, 2014 to 19.7% at December 31, 2015.

Our capital ratios declined in 2015 primarily as a result of the aforementioned repayment of \$63.5 million in SBLF stock. Earnings of \$27 million during 2015 partially offset the impact of the repayment. All of our capital ratios have significantly exceeded the regulatory thresholds for “well-capitalized” status for all periods covered by this report. Our tangible common equity ratio was 8.13% at December 31, 2015, compared to 7.90% at December 31, 2014 and 7.46% at December 31, 2013.

At December 31, 2015, our non-covered nonperforming assets to total non-covered assets was 2.37% compared to 3.09% at December 31, 2014. The decrease is primarily due to on-going resolution of nonperforming assets and improving credit quality.

As it relates to our covered assets, it has now been over six years since we acquired Cooperative Bank and five years since we acquired The Bank of Asheville in failed bank acquisitions, and we have worked through many of the problem assets related to these acquisitions. Our covered nonperforming assets have steadily declined over the past two years from \$71 million at December 31, 2013 to \$19 million at December 31, 2014 to \$12 million at December 31, 2015.

## **Distribution of Assets and Liabilities**

Table 7 sets forth the percentage relationships of significant components of our balance sheet at December 31, 2015, 2014, and 2013.

Our balance sheet mix has remained relatively stable over the past three years. On the asset side, our interest-earning assets have increased while the FDIC indemnification asset and foreclosed real estate percentages have decreased. In 2015, we experienced growth in loans that resulted in loans increasing from 73% of total assets to 74% of total assets. In 2014, we experienced a net decline in loans resulting in loans decreasing from 76% of total assets to 73% of total assets. In 2014, we used a portion of our excess cash to invest in held to maturity securities, which increased from 2% of total assets to 6% of total assets.

On the liability side, as previously discussed, in 2015, we experienced a net increase in total deposits and continued to experience shifts from time deposits to our transaction accounts. We also obtained \$70 million additional borrowings in 2015 to help fund the loan growth that we experienced during the year. In 2014, we experienced a net decline in total deposits. We also obtained \$70 million in additional borrowings in 2014 to enhance our cash position and in anticipation of future loan growth, which resulted in borrowings increasing from 1% of total assets to 4% of total assets.

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Shareholders' equity decreased from 12% of total liabilities and shareholders' equity at December 31, 2014 to 10% at December 31, 2015 as a result of redeeming \$63.5 million in SBLF stock during the year.

## **Securities**

Information regarding our securities portfolio as of December 31, 2015, 2014, and 2013 is presented in Tables 8 and 9.

The composition of the investment securities portfolio reflects our investment strategy of maintaining an appropriate level of liquidity while providing a relatively stable source of income. The investment portfolio also provides a balance to interest rate risk and credit risk in other categories of the balance sheet while providing a vehicle for the investment of available funds, furnishing liquidity, and supplying securities to pledge as required collateral for certain deposits. We obtain fair values for the vast majority of our investment securities from a third-party investment recordkeeper, who specializes in securities purchases and sales, recordkeeping, and valuation. This recordkeeper provides us with a third-party report that contains an evaluation of internal controls that includes testwork of securities valuation. We further test the values we receive by comparing the values for a significant sample of securities to another third-party valuation service on a quarterly basis.

Total securities amounted to \$320.2 million, \$336.7 million, and \$223.1 million at December 31, 2015, 2014, and 2013, respectively. The decrease in securities in 2015 was primarily due to securities paydowns, maturities, and calls. The increase in securities during 2014 was the result of our late-2014 decision to invest approximately \$125 million of excess cash into securities in an effort to increase our earning asset yield. The \$125 million investment was made in the form of government enterprise mortgage-backed securities that had an average yield of 2.43%, an average life of 7.1 years and an average duration of 6.1 years. These securities were classified in the held to maturity category.

The majority of our "government-sponsored enterprise" securities carry one maturity date, often with an issuer call feature. At December 31, 2015, of the \$19.0 million (carrying value) in government-sponsored enterprise securities, \$7.0 million were issued by the Federal Home Loan Bank system, \$9.0 million were issued by Freddie Mac/Fannie Mae, and the remaining \$3.0 million were issued by the Federal Farm Credit Bank system.

Our \$224.1 million in total mortgage-backed securities have all been issued by Freddie Mac, Fannie Mae, Ginnie Mae, or the Small Business Administration, each of which are government-sponsored corporations. We have no "private label" mortgage-backed securities. Mortgage-backed securities vary in their repayment in correlation with the underlying pools of mortgage loans.



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At December 31, 2015, our \$24.9 million investment in corporate bonds was comprised of the following:

(\$ in thousands)

| Issuer   | Issuer Ratings | Maturity Date | Amortized Cost | Market Value |
|--|----------------|---------------|----------------|--------------|
| Bank of America  | BBB+           | (1) 1/11/2023 | \$ 5,021       | 4,939        |
| Goldman Sachs  | BBB+           | (1) 1/22/2023 | 5,126          | 5,074        |
| JP Morgan Chase  | A-             | (1) 1/25/2023 | 5,031          | 5,001        |
| Citigroup  | BBB+           | (1) 3/1/2023  | 5,038          | 5,012        |
| Financial Institutions, Inc.                                     | BBB-           | (2) 4/15/2030 | 4,000          | 3,980        |
| First Citizens Bancorp (South Carolina) Trust Preferred Security | Not Rated      | 6/15/2034     | 1,000          | 940          |
| Total investment in corporate bonds                              |                |               | \$ 25,216      | 24,946       |

(1) Ratings issued by S&P

(2) Rating issued by Kroll Bond Rating (KBRA)

We have concluded that any unrealized losses associated with our corporate bonds are due to coupon rate considerations and not due to credit concerns.

We held \$154.6 million in securities held to maturity at December 31, 2015, which had a fair value that exceeded their carrying value by \$2.5 million. Approximately \$102.5 million of the securities held to maturity are mortgage-backed securities that have been issued by either Freddie Mac or Fannie Mae. The remaining \$52.1 million in securities held to maturity are comprised almost entirely of municipal bonds issued by state and local governments throughout our market area. We have only two municipal bonds with a denomination of \$2 million or greater and we have no significant concentration of bond holdings from one government entity, with the single largest exposure to any one entity being \$3.6 million. Management evaluated any unrealized losses on individual securities at each year end and determined them to be of a temporary nature and caused by fluctuations in market interest rates, not by concerns about the ability of the issuers to meet their obligations.

At December 31, 2015, 2014 and 2013, net unrealized losses of \$1.2 million, \$0.7 million and \$2.0 million, respectively, were included in the carrying value of securities classified as available for sale. Management evaluated any unrealized losses on individual securities at each year end and determined them to be of a temporary nature and caused by fluctuations in market interest rates and the overall economic environment, not by concerns about the ability of the issuers to meet their obligations. Net unrealized losses, net of applicable deferred income taxes, of \$0.7 million, \$0.4 million, and \$1.2 million have been reported as part of a separate component of shareholders' equity (accumulated other comprehensive income) as of December 31, 2015, 2014, and 2013, respectively.

The weighted average taxable-equivalent yield for the securities available for sale portfolio was 2.23% at December 31, 2015. The expected weighted average life of the available for sale portfolio using the call date for above-market callable bonds, the maturity date for all other non-mortgage-backed securities, and the expected life for mortgage-backed securities, was 5.5 years.

The weighted average taxable-equivalent yield for the securities held to maturity portfolio was 3.24% at December 31, 2015. The expected weighted average life of the held to maturity portfolio using the call date for above-market callable bonds, the expected life for mortgage-backed securities, and the maturity date for all other securities, was 4.0 years.

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The following table provides the names of issuers for which the Company has investment securities totaling in excess of 10% of shareholders' equity and the fair value and amortized cost of these investments as of December 31, 2015. All of these securities are issued by government sponsored corporations.

(\$ in thousands)

| Issuer                        | Amortized Cost | Fair Value | % of Shareholders' Equity |   |
|-------------------------------|----------------|------------|---------------------------|---|
| Freddie Mac                   | \$ 80,835      | 80,525     | 23.6                      | % |
| Fannie Mae                    | 62,717         | 62,301     | 18.3                      | % |
| Small Business Administration | 46,592         | 45,864     | 13.6                      | % |
| Ginnie Mae                    | 43,838         | 43,623     | 12.8                      | % |
| Total                         | \$ 233,982     | 232,313    |                           |   |

**Loans**

Table 10 provides a summary of the loan portfolio composition of our total loans at each of the past five year ends.

The loan portfolio is the largest category of our earning assets and is comprised of commercial loans, real estate mortgage loans, real estate construction loans, and consumer loans. We restrict virtually all of our lending to our 32 county market area, which is located in western, central and eastern North Carolina, four counties in southern Virginia and three counties in northeastern South Carolina. The diversity of the region's economic base has historically provided a stable lending environment.

As previously discussed, in our acquisitions of Cooperative Bank and The Bank of Asheville, we entered into loss share agreements with the FDIC, which afforded us significant protection from losses on all loans and other real estate acquired in those acquisitions. Because of the loss protection provided by the FDIC, the financial risk of the Cooperative Bank and The Bank of Asheville loans became significantly different from assets not covered under the loss share agreements. Accordingly, we present separately loans subject to the FDIC loss share agreements as "covered loans" and loans that are not subject to the loss share agreements as "non-covered loans." Table 10a presents a breakout of covered and non-covered loans as of December 31, 2015.

On July 1, 2014, one of the Company's loss share agreements with the FDIC expired. The agreement that expired related to the non-single family assets of Cooperative Bank, a failed bank acquisition from June 2009. Accordingly, the remaining balances associated with these loans and foreclosed real estate were transferred from the covered portfolio to the non-covered portfolio on July 1, 2014. The Company will bear all future losses on this portfolio of



loans and foreclosed real estate. Immediately prior to the transfer to non-covered status, the loans in this portfolio had a carrying value of \$39.7 million and the foreclosed real estate in this portfolio had a carrying value of \$3.0 million. Of the \$39.7 million in loans that lost loss share protection, approximately \$9.7 million were on nonaccrual status and \$2.1 million were classified as accruing troubled debt restructurings as of July 1, 2014. Additionally, approximately \$1.7 million in allowance for loan losses associated with this portfolio of loans was transferred to the allowance for loan losses for non-covered loans on July 1, 2014.

In 2015, loans outstanding increased \$122.8 million, or 5.1% to \$2.5 billion. The 2015 increase was primarily due to improved loan demand in our market areas, as well as the hiring of several experienced bankers during the year. In 2014, total loans outstanding decreased \$67.0 million, or 2.7% to \$2.4 billion. We believe that 2014 loan growth was impacted by a relatively slow economic recovery in many of the Company's market areas, as well as temporary pressures from new internal loan processes that we implemented in 2014 designed to enhance loan quality. Additionally, total covered loans declined by \$82.7 million in 2014 (see discussion above regarding a transfer to non-covered status).

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The majority of our loan portfolio over the years has been real estate mortgage loans, with loans secured by real estate consistently comprising 90% to 91% of our outstanding loan balances. Except for real estate construction, land development and other land loans, the majority of our “real estate” loans are personal and commercial loans where cash flow from the borrower’s occupation or business is the primary repayment source, with the real estate pledged providing a secondary repayment source.

Table 10 presents a five year history of loans outstanding by type. Real estate construction loans peaked at 23% of total loans in 2007 prior to the recession. These loans experienced the highest losses during the recession and, we, like many banks, tightened underwriting criteria for those loans during that period. As a result, our percentage of real estate construction loans to total loans steadily declined to 12% by December 31, 2013, where it has remained at each year end since. Residential real estate loans have declined from 34% of total loans at December 31, 2013 to 31% of total loans at December 31, 2015, as many customers have taken advantage of the historically low level of interest rates and refinanced their home loans with long-term fixed rate loans, which we typically sell in the secondary market. Commercial real estate loans as a percentage of total loans has increased steadily over the past five years and amounted to 38% of all loans at December 31, 2015. We participated in the Small Business Fund beginning in 2011, which provided monetary incentives for our bank to originate small business loans, which we typically secure with real estate collateral. Additionally, during 2015, we hired several experienced community bankers who originated a significant amount of business loans secured by real estate. Our emphasis on this type of loan is consistent with our community banking strategy.

Table 11 provides a summary of scheduled loan maturities over certain time periods, with fixed rate loans and adjustable rate loans shown separately. Approximately 14% of our accruing loans outstanding at December 31, 2015 mature within one year and 58% of total loans mature within five years. As of December 31, 2015, the percentages of variable rate loans and fixed rate loans as compared to total performing loans were 33% and 67%, respectively. We intentionally make a blend of fixed and variable rate loans so as to reduce interest rate risk. The mix of fixed rate loans has steadily increased over the past several years because many borrowers desire to lock in an interest rate during the historically low interest rate environment that has been in effect. While this presents risk to our company if interest rates rise, we measure our interest rate risk closely and, as discussed in the section “Interest Rate Risk” below, we do not believe that an increase in interest rates would materially negatively impact our net interest income.

## **Nonperforming Assets**

Nonperforming assets include nonaccrual loans, troubled debt restructurings, loans past due 90 or more days and still accruing interest, nonperforming loans held for sale, and foreclosed real estate. As a matter of policy we place all loans that are past due 90 or more days on nonaccrual basis, and thus there were no loans at any of the past five year ends that were 90 days past due and still accruing interest.

Nonaccrual loans are loans on which interest income is no longer being recognized or accrued because management has determined that the collection of interest is doubtful. Placing loans on nonaccrual status negatively impacts

earnings because (i) interest accrued but unpaid as of the date a loan is placed on nonaccrual status is reversed and deducted from interest income, (ii) future accruals of interest income are not recognized until it becomes probable that both principal and interest will be paid and (iii) principal charged-off, if appropriate, may necessitate additional provisions for loan losses that are charged against earnings. In some cases, where borrowers are experiencing financial difficulties, loans may be restructured to provide terms significantly different from the originally contracted terms.

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Table 12 summarizes our nonperforming assets at the dates indicated. Because of the loss protection provided by the FDIC, we present separately nonperforming assets subject to the loss share agreements as “covered” and nonperforming assets that are not subject to the loss share agreements as “non-covered.”

Due largely to the economic downturn that began in late 2007 and continued to worsen over succeeding years, we experienced significant increases in our non-covered nonperforming assets, with total non-covered nonperforming assets rising steadily from \$11 million at December 31, 2007 to a peak of \$146 million at September 30, 2012.

In order to reduce our level of nonperforming assets and lower our overall risk profile, in the fourth quarter of 2012, we identified approximately \$68 million of non-covered higher-risk loans, including both performing and non-performing loans, that we targeted for a sale to a third party investor. Based on an offer to purchase these loans that was received in December 2012, we wrote-down the loans by approximately \$38 million to their estimated liquidation value of approximately \$30 million and reclassified them as “loans held for sale.” Of the \$68 million in loans targeted for sale, approximately \$38 million had been classified as nonaccrual loans, \$11 million had been classified as accruing troubled debt restructurings and the remaining \$19 million performing classified loans. The completion of the sale of these loans occurred in January 2013 with sales proceeds of approximately \$30 million being received. In the fourth quarter of 2012, we also recorded write-downs totaling \$10.6 million on substantially all of our non-covered foreclosed properties in connection with efforts to accelerate the sale of these assets.

As a result of the above actions, our non-covered nonperforming assets decreased from their peak level of \$146 million at September 30, 2012 to \$106 million at December 31, 2012, which reflects the write-downs of the loans and foreclosed properties, to \$83 million at March 31, 2013, which reflects the completion of the January 2013 loan sale. Non-covered nonperforming assets amounted to \$95 million at December 31, 2014 compared to \$82 million at December 31, 2013. As discussed above, during 2014, we transferred approximately \$15 million in nonperforming assets from covered status to non-covered status, which caused the increase from 2013 to 2014. At December 31, 2015, non-covered nonperforming assets amounted to \$77.2 million, a decrease of \$18.1 million from December 31, 2014. The decline in non-covered nonperforming assets is primarily due to on-going resolution of nonperforming assets and improving credit quality. At December 31, 2015, the ratio of non-covered nonperforming assets to total non-covered assets was 2.37% compared to 3.09% and 2.78% at December 31, 2014 and 2013, respectively.

Total covered nonperforming assets have significantly declined during the past two years, amounting to \$12.1 million at December 31, 2015 compared to \$18.7 million and \$70.6 million at December 31, 2014 and 2013, respectively, with \$15 million of the 2014 decline attributable to the transfer to non-covered status. Within this category, foreclosed real estate has declined to \$0.8 million compared to \$2.4 million at December 31, 2014 and \$24.5 million at December 31, 2013. The Company continues to experience good property sales activity, particularly along the North Carolina coast, where most of the Company’s covered foreclosed properties are located.

Table 12a presents our nonperforming assets at December 31, 2015 by general geographic region and further segregated into “covered” nonperforming assets and “non-covered” nonperforming assets.



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The following is the composition, by loan type, of all of our nonaccrual loans at each period end, as classified for regulatory purposes:

| (\$ in thousands)  | At December 31,<br>2015 (1) | At December 31,<br>2014 (1) |
|--|-----------------------------|-----------------------------|
| Commercial, financial, and agricultural                            | \$ 2,964                    | 3,575                       |
| Real estate – construction, land development, and other land loans | 4,704                       | 10,079                      |
| Real estate – mortgage – residential (1-4 family) first mortgages  | 23,829                      | 26,916                      |
| Real estate – mortgage – home equity loans/lines of credit         | 3,525                       | 4,214                       |
| Real estate – mortgage – commercial and other                      | 12,571                      | 15,190                      |
| Installment loans to individuals                                   | 217                         | 600                         |
| Total nonaccrual loans   | \$ 47,810                   | 60,574                      |

(1) Includes both covered and non-covered loans.

The following segregates our nonaccrual loans at December 31, 2015 into covered and non-covered loans, as classified for regulatory purposes:

| (\$ in thousands)  | Covered<br>Nonaccrual<br>Loans | Non-covered<br>Nonaccrual<br>Loans | Total<br>Nonaccrual<br>Loans |
|--|--------------------------------|------------------------------------|------------------------------|
| Commercial, financial, and agricultural                            | \$ —                           | 2,964                              | 2,964                        |
| Real estate – construction, land development, and other land loans | 52                             | 4,652                              | 4,704                        |
| Real estate – mortgage – residential (1-4 family) first mortgages  | 5,007                          | 18,822                             | 23,829                       |
| Real estate – mortgage – home equity loans/lines of credit         | 383                            | 3,142                              | 3,525                        |
| Real estate – mortgage – commercial and other                      | 2,374                          | 10,197                             | 12,571                       |
| Installment loans to individuals                                   | —                              | 217                                | 217                          |
| Total nonaccrual loans   | \$ 7,816                       | 39,994                             | 47,810                       |

The following segregates our nonaccrual loans at December 31, 2014 into covered and non-covered loans, as classified for regulatory purposes:

| (\$ in thousands)  | Covered<br>Nonaccrual<br>Loans | Non-covered<br>Nonaccrual<br>Loans | Total<br>Nonaccrual<br>Loans |
|--|--------------------------------|------------------------------------|------------------------------|
| Commercial, financial, and agricultural                            | \$ 104                         | 3,471                              | 3,575                        |
| Real estate – construction, land development, and other land loans | 1,140                          | 8,939                              | 10,079                       |
| Real estate – mortgage – residential (1-4 family) first mortgages  | 7,724                          | 19,192                             | 26,916                       |
| Real estate – mortgage – home equity loans/lines of credit         | 339                            | 3,875                              | 4,214                        |

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|   |           |        |        |
|---|-----------|--------|--------|
| Real estate – mortgage – commercial and other | 1,201     | 13,989 | 15,190 |
| Installment loans to individuals              | —         | 600    | 600    |
| Total nonaccrual loans                        | \$ 10,508 | 50,066 | 60,574 |

The nonaccrual tables above generally indicate that we experienced decreases in all categories of nonaccrual loans, with the “real estate – construction” category experiencing the largest decline. The decline in nonaccrual loans is due to our on-going focus to resolve our nonperforming loans and improving credit quality.

Management routinely monitors the status of certain large loans that, in management’s opinion, have credit weaknesses that could cause them to become nonperforming loans. In addition to the nonperforming loan amounts discussed above, management believes that an estimated \$5 million of non-covered loans and \$1 million of covered loans that were performing in accordance with their contractual terms at December 31, 2015 have the potential to develop problems depending upon the particular financial situations of the borrowers and economic conditions in general. Management has taken these potential problem loans into consideration when evaluating the adequacy of the allowance for loan losses at December 31, 2015 (see discussion below).

Loans classified for regulatory purposes as loss, doubtful, substandard, or special mention that have not been disclosed in the problem loan amounts and the potential problem loan amounts discussed above do not represent or result from trends or uncertainties that management reasonably expects will materially impact future operating results, liquidity, or capital resources, or represent material credits about which management is aware of any information that causes management to have serious doubts as to the ability of such borrowers to comply with the loan repayment terms.

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We provide additional information regarding the classification status of our loans in tables contained in Note 4 to our consolidated financial statements. As it relates to non-covered loans, those tables indicate that from December 31, 2014 to December 31, 2015 our asset quality improved, with total non-covered classified and nonaccrual loans decreasing from \$125 million at December 31, 2014 to \$102 million at December 31, 2015.

Foreclosed real estate includes primarily foreclosed properties. Non-covered foreclosed real estate amounted to \$9.2 million, \$9.8 million, and \$12.3 million at December 31, 2015, 2014, and 2013, respectively. Foreclosed property levels have steadily declined in a manner consistent with our strategy implemented in 2012 to accelerate the disposition of foreclosed properties.

At December 31, 2015, 2014 and 2013, we also held \$0.8 million, \$2.4 million, and \$24.5 million, respectively, in foreclosed real estate subject to loss share agreements with the FDIC. The declines in 2014 and 2015 were primarily due to sales of these foreclosed properties as a result of increased property sales activity, particularly along the North Carolina coast, where most of our covered foreclosed properties are located.

The following table presents the detail of our foreclosed real estate at each of the past two year ends:

|                                   | At December 31,<br>2015 (1)                        | At December 31,<br>2014 (1) |
|-----------------------------------|--|-----------------------------|
| Vacant land                       | \$ 3,867   | 4,964                       |
| 1-4 family residential properties | 3,789  | 2,878                       |
| Commercial real estate            | 2,338  | 4,279                       |
| Total foreclosed real estate      | \$ 9,994   | 12,121                      |
| (1)                               | Includes both covered and non-covered real estate. |                             |

The following segregates our foreclosed real estate at December 31, 2015 into covered and non-covered:

|                                   | Covered<br>Foreclosed Real<br>Estate | Non-covered<br>Foreclosed Real<br>Estate | Total Foreclosed<br>Real Estate |
|-----------------------------------|--------------------------------------|--|---------------------------------|
| Vacant land                       | \$ 277                               | 3,590                                    | 3,867                           |
| 1-4 family residential properties | 247                                  | 3,542                                    | 3,789                           |
| Commercial real estate            | 282                                  | 2,056                                    | 2,338                           |
| Total foreclosed real estate      | \$ 806                               | 9,188                                    | 9,994                           |

The following segregates our foreclosed real estate at December 31, 2014 into covered and non-covered:



|                                   | Covered<br>Foreclosed Real<br>Estate | Non-covered<br>Foreclosed Real<br>Estate | Total Foreclosed<br>Real Estate |
|-----------------------------------|--------------------------------------|--|---------------------------------|
| Vacant land                       | \$ 639                               | 4,325                                    | 4,964                           |
| 1-4 family residential properties | 866                                  | 2,012                                    | 2,878                           |
| Commercial real estate            | 845                                  | 3,434                                    | 4,279                           |
| Total foreclosed real estate      | \$ 2,350                             | 9,771                                    | 12,121                          |

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**Allowance for Loan Losses and Loan Loss Experience**

The allowance for loan losses is created by direct charges to operations (known as a “provision for loan losses” for the period in which the charge is taken). Losses on loans are charged against the allowance in the period in which such loans, in management’s opinion, become uncollectible. The recoveries realized during the period are credited to this allowance. We consider our procedures for recording the amount of the allowance for loan losses and the related provision for loan losses to be a critical accounting policy. See the heading “Critical Accounting Policies” above for further discussion.

The factors that influence management’s judgment in determining the amount charged to operating expense include recent loan loss experience, composition of the loan portfolio, evaluation of probable inherent losses and current economic conditions.

We use a loan analysis and grading program to facilitate our evaluation of probable inherent loan losses and the adequacy of our allowance for loan losses. In this program, credit risk grades are assigned by management and tested by an independent third party consulting firm. The testing program includes an evaluation of a sample of new loans, loans we identify as having potential credit weaknesses, loans past due 90 days or more, loans originated by new loan officers, nonaccrual loans and any other loans identified during previous regulatory and other examinations.

We strive to maintain our loan portfolio in accordance with what management believes are conservative loan underwriting policies that result in loans specifically tailored to the needs of our market areas. Every effort is made to identify and minimize the credit risks associated with such lending strategies. We have no foreign loans, few agricultural loans and do not engage in significant lease financing or highly leveraged transactions. Commercial loans are diversified among a variety of industries. The majority of loans captioned in the tables discussed below as “real estate” loans are personal and commercial loans where real estate provides additional security for the loan. Collateral for virtually all of these loans is located within our principal market area.

The allowance for loan losses amounted to \$28.6 million at December 31, 2015 compared to \$40.6 million at December 31, 2014 and \$48.5 million at December 31, 2013. At December 31, 2015, 2014, and 2013, \$1.8 million, \$2.3 million, and \$4.2 million, respectively, of the allowance for loan losses is attributable to covered loans that have exhibited credit quality deterioration due to lower collateral valuations, while the allowance for loan losses for non-covered loans amounted to \$26.8 million, \$38.3 million, and \$44.3 million, respectively, at those dates.

Our allowance for loan loss model utilizes the net charge-offs experienced in the most recent years as a significant component of estimating the current allowance for loan losses that is necessary. Thus, older years (and parts thereof)

systematically age out and are excluded from the analysis as time goes on. The final periods of high net charge-offs we experienced during the peak of the recession dropped out of the analysis in 2015 and were replaced by the more modest levels of net charge-offs now being experienced. The fourth quarter of 2015 marked our twelfth consecutive quarter of annualized net charge-offs related to non-covered loans being less than 1.00%, whereas at the peak of the recession, that ratio was frequently over 1.00%. Accordingly, the relatively low provision for non-covered loans recorded in 2015 resulted in our non-covered allowance for loan loss declining to a more normalized level following the elevated amounts we maintained during and immediately following the recession. In 2016, we expect that it is likely we will record a higher amount of provision for loan losses than we did in 2015, as we provide for on-going loan charge-offs and expected new loan growth.

The ratio of the allowance for non-covered loan losses to non-covered loans was 1.11%, 1.69%, and 1.96%, as of December 31, 2015, 2014, and 2013, respectively. The decline in this ratio during 2015 was the result of \$13.6 million in net charge-offs recorded that reduced the allowance for loan losses and which significantly exceeded the \$2.0 million added to the allowance for loan losses via provisions for loan losses.

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Table 13 sets forth the allocation of the allowance for loan losses at the dates indicated. The amount of the unallocated portion of the allowance for loan losses did not vary materially at any of the past three year ends. The allowance for loan losses is available to absorb losses in all categories. Table 13a segregates the allocation of the allowance for loan losses as of December 31, 2015 and 2014 into covered and non-covered categories.

Management considers the allowance for loan losses adequate to cover probable loan losses on the loans outstanding as of each reporting date. It must be emphasized, however, that the determination of the allowance using our procedures and methods rests upon various judgments and assumptions about economic conditions and other factors affecting loans. No assurance can be given that we will not in any particular period sustain loan losses that are sizable in relation to the amount reserved or that subsequent evaluations of the loan portfolio, in light of conditions and factors then prevailing, will not require significant changes in the allowance for loan losses or future charges to earnings.

In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan losses and losses on foreclosed real estate. Such agencies may require us to recognize additions to the allowance based on the examiners' judgments about information available to them at the time of their examinations.

For the years indicated, Table 14 summarizes our balances of loans outstanding, average loans outstanding, and a detailed rollforward of the allowance for loan losses.

Table 14a presents a detailed rollforward of the 2015 and 2014 activity for the allowance for loan losses segregated into covered and non-covered activity.

Net loan charge-offs of non-covered loans amounted to \$13.6 million in 2015, \$14.7 million in 2014, and \$15.6 million in 2013. Net non-covered charge-offs as a percentage of average non-covered loans represented 0.58%, 0.65%, and 0.72% during 2015, 2014, and 2013, respectively. The trend of lower net charge-offs is associated with lower levels of nonperforming loans that have been impacted with improvements in the economy and real estate prices.

We recorded (\$2.3 million), \$3.3 million, and \$12.9 million in net charge-offs (recoveries) of covered loans during 2015, 2014, and 2013, respectively. In 2015, we received recoveries of \$3.6 million, which more than offset charge-offs of \$1.3 million. The significant improvements in 2015 and 2014 were primarily a result of lower levels of classified covered loans.

## Deposits

At December 31, 2015, deposits outstanding amounted to \$2.811 billion, an increase of \$115 million from the \$2.696 billion at December 31, 2014. During 2015 we experienced strong growth in our noninterest-bearing and interest-bearing checking accounts, and declines in our higher cost time deposits, including brokered time deposits and internet time deposits.

At December 31, 2014, deposits outstanding amounted to \$2.696 billion, a decrease of \$55 million from the \$2.751 billion at December 31, 2013. Similar to 2015, during 2014, we experienced strong growth in our noninterest-bearing and interest-bearing checking accounts. However, these increases were offset by declines in our higher cost time deposits, including brokered time deposits and internet time deposits. We were able to lessen our reliance on higher-cost time deposits due to the continued growth in our transaction accounts and cash generated from our FDIC loss-share reimbursements and sales of foreclosed properties.

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The nature of our deposit growth is illustrated in the table on page 55. The following table reflects the mix of our deposits at each of the past three year ends:

|                                       | 2015 | 2014 | 2013 |
|---------------------------------------|------|------|------|
| Noninterest-bearing checking accounts | 23%  | 21%  | 18%  |
| Interest-bearing checking accounts    | 22%  | 22%  | 20%  |
| Money market deposits                 | 23%  | 20%  | 20%  |
| Savings deposits                      | 7%   | 7%   | 6%   |
| Brokered deposits                     | 3%   | 3%   | 4%   |
| Internet deposits                     | 0%   | 0%   | 0%   |
| Time deposits > \$100,000 – retail    | 12%  | 14%  | 16%  |
| Time deposits < \$100,000 – retail    | 10%  | 13%  | 16%  |
| Total deposits                        | 100% | 100% | 100% |

Our deposit mix has shifted over the past few years to a heavier concentration in transaction accounts and less concentration in time deposits. The percentages for retail time deposits have declined because of a combination of 1) customers shifting their matured time deposits into checking accounts because of a steadily shrinking gap between the interest rates that the two products pay and 2) because of satisfactory levels of liquidity, we have chosen not to match certain promotional time deposit interest rates being offered by local competitors.

We routinely engage in activities designed to grow and retain deposits, such as (1) emphasizing relationship banking to new and existing customers, where borrowers are encouraged and normally expected to maintain deposit accounts with us, (2) pricing deposits at rate levels that will attract and/or retain deposits, and (3) continually working to identify and introduce new products that will attract customers or enhance our appeal as a primary provider of financial services.

Table 15 presents the average amounts of our deposits and the average yield paid for those deposits for the years ended December 31, 2015, 2014, and 2013.

As of December 31, 2015, we held approximately \$403.5 million in time deposits of \$100,000 or more. Table 16 is a maturity schedule of time deposits of \$100,000 or more as of December 31, 2015. This table shows that 81% of our time deposits greater than \$100,000 mature within one year.

At each of the past three year ends, we have no deposits issued through foreign offices, nor do we believe that we held any deposits by foreign depositors.

## **Borrowings**

Our borrowings outstanding totaled \$186.4 million at December 31, 2015, \$116.4 million at December 31, 2014 and \$46.4 million at December 31, 2013. In 2015, we obtained new borrowings of \$70 million from a low cost funding source to help support our loan growth experienced during the year. In 2014, we obtained new borrowings of \$70 million from a low cost funding source in order to enhance our cash position and in anticipation of future loan growth.

Table 2 shows that average borrowings were \$149.8 million in 2015, \$99.4 million in 2014, and \$46.4 million in 2013.

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At December 31, 2015, the Company had four sources of readily available borrowing capacity – 1) an approximately \$589 million line of credit with the FHLB, of which \$140 million and \$70 million was outstanding at December 31, 2015 and 2014, respectively, 2) a \$50 million overnight federal funds line of credit with a correspondent bank, of which none was outstanding at December 31, 2015 or 2014, and 3) a \$35 million federal funds line of credit with a correspondent bank, of which none was outstanding at December 31, 2015, and 4) an approximately \$88 million line of credit through the Federal Reserve Bank of Richmond's (FRB) discount window, of which none was outstanding at December 31, 2015 or 2014.

Our line of credit with the FHLB can be structured as either short-term or long-term borrowings, depending on the particular funding or liquidity need, and is secured by our FHLB stock and a blanket lien on most of our real estate loan portfolio. For the year ended December 31, 2015, the average amount of FHLB borrowings outstanding was approximately \$103 million with a weighted average interest rate for the year of 0.54%. The maximum amount of short-term FHLB borrowings outstanding at any month-end during 2015 was \$180 million. For the year ended December 31, 2014, the average amount of FHLB borrowings outstanding was approximately \$53 million with a weighted average interest rate for the year of 0.27%. The maximum amount of short-term FHLB borrowings outstanding at any month-end during 2014 was \$70 million.

In addition to any outstanding borrowings from the FHLB that reduce the available borrowing capacity of the line of credit, our borrowing capacity was further reduced by \$193 million at both December 31, 2015 and 2014, as a result of our pledging letters of credit backed by the FHLB for public deposits at each of those dates.

Our two correspondent bank relationships allow us to purchase up to \$50 million and \$35 million in federal funds on an overnight, unsecured basis (federal funds purchased). We had no borrowings under these lines at December 31, 2015 or 2014. There were no federal funds purchased outstanding at any month-end during 2015 or 2014.

We also have a line of credit with the FRB discount window. This line is secured by a blanket lien on a portion of our commercial and consumer loan portfolio (excluding real estate loans). Based on the collateral that we owned as of December 31, 2015, the available line of credit was approximately \$88 million. At December 31, 2015 and 2014, we had no borrowings outstanding under this line. The maximum amount of FRB borrowings outstanding at any month-end during 2015 or 2014 was \$0 and \$20 million, respectively.

In addition to the lines of credit described above, we also had a total of \$46.4 million in trust preferred security debt outstanding at December 31, 2015 and 2014. We have initiated three trust preferred security issuances since 2002 totaling \$67.0 million, with one of those issuances for \$20.6 million being redeemed in 2007. These borrowings each have 30 year final maturities and were structured in a manner that allows them to qualify as capital for regulatory capital adequacy requirements. We may call these debt securities at par on any quarterly interest payment date five years after their issue date. We issued \$20.6 million of this debt on October 29, 2002 (which we called in 2007), an additional \$20.6 million on December 19, 2003, and \$25.8 million on April 13, 2006. The interest rate on these debt securities adjusts on a quarterly basis at a rate of three-month LIBOR plus 2.70% for the securities issued in 2003, and



three-month LIBOR plus 1.39% for the securities issued in 2006.

### **Liquidity, Commitments, and Contingencies**

Our liquidity is determined by our ability to convert assets to cash or to acquire alternative sources of funds to meet the needs of our customers who are withdrawing or borrowing funds, and our ability to maintain required reserve levels, pay expenses and operate the Company on an ongoing basis. Our primary liquidity sources are net income from operations, cash and due from banks, federal funds sold and other short-term investments. Our securities portfolio is comprised almost entirely of readily marketable securities which could also be sold to provide cash.

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As noted above, in addition to internally generated liquidity sources, at December 31, 2015, we had the ability to obtain borrowings from the following three sources – 1) an approximately \$589 million line of credit with the FHLB, 2) a \$50 million overnight federal funds line of credit with a correspondent bank, 3) a \$35 million federal funds line with a correspondent bank, and 4) an approximately \$88 million line of credit through the FRB’s discount window.

Our overall liquidity decreased slightly in 2015 compared to 2014 due primarily to loan growth and the redemption of the \$63.5 million in SBLF stock. Our liquid assets (cash and securities) as a percentage of our total deposits and borrowings decreased from 21.2% at December 31, 2014 to 19.7% at December 31, 2015.

We continue to believe our liquidity sources, including unused lines of credit, are at an acceptable level and remain adequate to meet our operating needs in the foreseeable future. We will continue to monitor our liquidity position carefully and will explore and implement strategies to increase liquidity if deemed appropriate.

In the normal course of business we have various outstanding contractual obligations that will require future cash outflows. In addition, there are commitments and contingent liabilities, such as commitments to extend credit, that may or may not require future cash outflows.

Table 18 reflects our contractual obligations and other commercial commitments outstanding as of December 31, 2015. Any of our \$140 million in outstanding borrowings with the FHLB may be accelerated immediately by the FHLB in certain circumstances, including material adverse changes in our condition or if our qualifying collateral is less than the amount required under the terms of the borrowing agreement.

In the normal course of business there are various outstanding commitments and contingent liabilities such as commitments to extend credit, which are not reflected in the financial statements. The following table presents a summary of our outstanding loan commitments as of December 31, 2015:

(\$ in millions)

| Type of Commitment  | Fixed Rate | Variable Rate | Total |
|---|------------|---------------|-------|
| Outstanding closed-end loan commitments   | \$ 81      | 156           | 237   |
| Unfunded commitments on revolving lines of credit, credit cards and home equity loans | 69         | 218           | 287   |
| Total   | \$ 150     | 374           | 524   |

At December 31, 2015 and 2014, we also had \$13.1 million and \$14.1 million, respectively, in standby letters of credit outstanding. We had no carrying amount for these standby letters of credit at either of those dates. The nature of the

standby letters of credit is that of a guarantee made on behalf of our customers to suppliers of the customers to guarantee payments owed to the supplier by the customer. The standby letters of credit are generally for terms of one year, at which time they may be renewed for another year if both parties agree. The payment of the guarantees would generally be triggered by a continued nonpayment of an obligation owed by the customer to the supplier. The maximum potential amount of future payments (undiscounted) we could be required to make under the guarantees in the event of nonperformance by the parties to whom credit or financial guarantees have been extended is represented by the contractual amount of the financial instruments discussed above. In the event that we are required to honor a standby letter of credit, a note, already executed by the customer, becomes effective providing repayment terms and any collateral. Over the past two years, we have had to honor only a few standby letters of credit, none of which resulted in any loss to the Company. We expect any draws under existing commitments to be funded through normal operations.

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It has been our experience that deposit withdrawals are generally able to be replaced with new deposits when needed. Based on that assumption, management believes that it can meet its contractual cash obligations and existing commitments from normal operations.

We are not involved in any legal proceedings that, in management's opinion, are likely to have a material effect on the consolidated financial position of the Company.

## **Capital Resources and Shareholders' Equity**

Shareholders' equity at December 31, 2015 amounted to \$342.2 million compared to \$387.7 million at December 31, 2014 and \$371.9 million at December 31, 2013. The two basic components that typically have the largest impact on our shareholders' equity are net income, which increases shareholders' equity, and dividends declared, which decreases shareholders' equity. Additionally, any stock issuances (redemptions) can significantly increase (decrease) shareholders' equity.

In 2015, the most significant factors that impacted our equity were 1) the \$63.5 million redemption of our Series B Preferred Stock issued to the U.S. Treasury in 2011 under the Small Business Lending Fund, which reduced equity (see Note 19 to our consolidated financial statements), 2) the \$27.0 million net income reported for 2015, which increased equity, 3) common stock dividends declared of \$6.3 million, which reduced equity. Another factor negatively impacting equity in 2015 was a \$2.7 million decrease in accumulated other comprehensive income that was caused primarily by an increase in our pension liability. The increase in the pension liability was primarily due to underperformance of our pension plan assets during 2015 (see Note 12 to the consolidated financial statements). See the Consolidated Statements of Shareholders' Equity within the consolidated financial statements for disclosure of other less significant items affecting shareholders' equity.

In 2014, the most significant factors that impacted our equity were 1) the \$25.0 million net income reported for 2014, which increased equity, 2) common stock dividends declared of \$6.3 million, which reduced equity, 3) preferred stock dividends declared of \$0.9 million, which reduced equity. Another significant factor negatively impacting equity in 2014 was a \$3.3 million decrease in accumulated other comprehensive income that was caused by an increase in our pension liability. The increase in the pension liability was primarily due to the impact of lower interest rates on the actuarial calculations involved in determining the liability. Our policy is to use the Citigroup Pension Index yield curve in the computation of the pension liability. At December 31, 2014, that index had a weighted average rate of 3.82%, which was a decline from the rate of 4.78% at December 31, 2013 (see Note 12 to the consolidated financial statements). See the Consolidated Statements of Shareholders' Equity within the consolidated financial statements for disclosure of other less significant items affecting shareholders' equity.

In 2013, the most significant factors that impacted our equity were 1) the \$20.7 million net income reported for 2013, which increased equity, 2) common stock dividends declared of \$6.3 million, which reduced equity, 3) preferred stock dividends declared of \$0.9 million, which reduced equity, and 4) a \$3.1 million increase in equity primarily related to unrealized gains experienced in our two pension plans (see Note 12), which was offset by a \$1.0 million decrease in equity related to unrealized losses in our securities portfolio. See the Consolidated Statements of Shareholders' Equity within the consolidated financial statements for disclosure of other less significant items affecting shareholders' equity.

At December 31, 2014 and 2013, we had \$63.5 million in Series B Preferred Stock that was issued in 2011 to the U.S. Treasury. This stock qualified as Tier I capital under all current and proposed regulatory rules. For 2013 and 2014, we paid preferred dividends on that stock at an annual rate of 1%. In June 2015, we redeemed \$32.5 million in the Series B Preferred Stock and in October 2015, we redeemed the remaining \$31 million outstanding (see additional discussion in Note 19 to the consolidated financial statements).

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In addition to shareholders' equity, we have supplemented our capital in past years with trust preferred security debt issuances, which because of their structure qualify as regulatory capital. This was necessary in past years because our balance sheet growth outpaced the growth rate of our capital. Additionally, we have frequently purchased bank branches over the years that resulted in our recording intangible assets, which negatively impacted regulatory capital ratios. As discussed in "Borrowings" above, we currently have \$46.4 million in trust preferred securities outstanding, all of which qualify as Tier I capital under both current and forthcoming regulatory standards.

We are not aware of any recommendations of regulatory authorities or otherwise which, if they were to be implemented, would have a material effect on our liquidity, capital resources, or operations.

The Company and the Bank must comply with regulatory capital requirements established by the Federal Reserve System (the "FED"). Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements.

In 2013, the FED approved final rules implementing the Basel Committee on Banking Supervision capital guidelines, referred to a "Basel III." The final rules established a new "Common Equity Tier I" ratio; new higher capital ratio requirements, including a capital conservation buffer; narrowed the definitions of capital; imposed new operating restrictions on banking organizations with insufficient capital buffers; and increased the risk weighting of certain assets. The final rules became effective January 1, 2015 for the Company.

Common Equity Tier I capital ("CET1") is comprised of common stock and related surplus, plus retained earnings, and is reduced by goodwill and other intangible assets, net of associated deferred tax liabilities. Tier I capital is comprised of Common Equity Tier I capital plus Additional Tier I capital, which for the Company includes non-cumulative perpetual preferred stock and trust preferred securities. Total capital is comprised of Tier I capital plus certain adjustments, the largest of which for the Company and the Bank is the allowance for loan losses. Risk-weighted assets refer to the on- and off-balance sheet exposures of the Company and the Bank, adjusted for their related risk levels using formulas set forth in FRB regulations.

Under the Basel III Capital Rules, the following are the initial minimum capital ratios applicable to the Company and the Bank as of January 1, 2015:

- 4.5% CET1 to risk-weighted assets;
- 6.0% Tier I capital (that is, CET1 plus Additional Tier I capital) to risk-weighted assets;
- 8.0% total capital (that is, Tier I capital plus Tier II capital) to risk-weighted assets; and
- 4.0% Tier I leverage ratio (that is Tier I capital to quarterly average total assets).

The Basel III Capital Rules also introduce a new “capital conservation buffer,” composed entirely of CET1, on top of these minimum risk-weighted asset ratios. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the capital conservation buffer will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall. The implementation of the capital conservation buffer began on January 1, 2016 at 0.625% and will be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019). Thus, when fully phased-in on January 1, 2019, the Company and the Bank will be required to maintain this additional capital conservation buffer of 2.5% of CET1, resulting in the following minimum capital ratios:

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- 4.5% CET1 to risk-weighted assets, plus the capital conservation buffer, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7%;
- 6.0% Tier I capital to risk-weighted assets, plus the capital conservation buffer, effectively resulting in a minimum Tier I capital ratio of at least 8.5%;
- 8.0% total capital to risk-weighted assets, plus the capital conservation buffer, effectively resulting in a minimum total capital ratio of at least 10.5%; and
- 4.0% Tier I leverage ratio

In addition to the minimum capital requirements described above, the regulatory framework for prompt corrective action also contains specific capital guidelines for a bank's classification as "well capitalized." The specific guidelines as of January 1, 2015 are as follows –

- Common Equity Tier I Capital Ratio of at least 6.50%;
- Tier I Capital Ratio of at least 8.00%;
- Total Capital Ratio of at least 10.00%; and a
- Leverage Ratio of at least 5.00%

If a bank falls below "well capitalized" status in any of these three ratios, it must ask for FDIC permission to originate or renew brokered deposits. The Bank's regulatory ratios exceeded the threshold for "well-capitalized" status at December 31, 2015, 2014, and 2013 – see Note 16 to the consolidated financial statements for a table that presents the Bank's regulatory ratios.

Table 21 presents our regulatory capital ratios as of December 31, 2015, 2014, and 2013. All of our capital ratios have significantly exceeded the minimum regulatory thresholds for all periods covered by this report.

In this economic environment, our goal is to maintain our capital ratios at levels at least 200 basis points higher than the "well-capitalized" thresholds set for banks. At December 31, 2015, our total risk-based capital ratio was 14.45% compared to the 10.00% "well-capitalized" threshold.

In addition to regulatory capital ratios, we also closely monitor our ratio of tangible common equity to tangible assets ("TCE Ratio"). Our TCE ratio was 8.13% at December 31, 2015 compared to 7.90% at December 31, 2014.

See "Supervision and Regulation" under "Business" above and Note 16 to the consolidated financial statements for discussion of other matters that may affect our capital resources.



## **Off-Balance Sheet Arrangements and Derivative Financial Instruments**

Off-balance sheet arrangements include transactions, agreements, or other contractual arrangements pursuant to which we have obligations or provide guarantees on behalf of an unconsolidated entity. We have no off-balance sheet arrangements of this kind other than letters of credit and repayment guarantees associated with our trust preferred securities.

Derivative financial instruments include futures, forwards, interest rate swaps, options contracts, and other financial instruments with similar characteristics. We have not engaged in significant derivatives activities through December 31, 2015 and have no current plans to do so.

## **Return on Assets and Equity**

Table 20 shows return on average assets (net income available to common shareholders divided by average total assets), return on average common equity (net income available to common shareholders divided by average common shareholders' equity), dividend payout ratio (dividends per share divided by net income per common share) and shareholders' equity to assets ratio (average total shareholders' equity divided by average total assets) for each of the years in the three-year period ended December 31, 2015.

Table of Contents**Interest Rate Risk (Including Quantitative and Qualitative Disclosures About Market Risk – Item 7A.)**

Net interest income is our most significant component of earnings. Notwithstanding changes in volumes of loans and deposits, our level of net interest income is continually at risk due to the effect that changes in general market interest rate trends have on interest yields earned and paid with respect to our various categories of earning assets and interest-bearing liabilities. It is our policy to maintain portfolios of earning assets and interest-bearing liabilities with maturities and repricing opportunities that will afford protection, to the extent practical, against wide interest rate fluctuations. Our exposure to interest rate risk is analyzed on a regular basis by management using standard GAP reports, maturity reports, and an asset/liability software model that simulates future levels of interest income and expense based on current interest rates, expected future interest rates, and various intervals of “shock” interest rates. Over the years, we have been able to maintain a fairly consistent yield on average earning assets (net interest margin). Over the past five calendar years, our net interest margin has ranged from a low of 4.13% (realized in 2015) to a high of 4.92% (realized in 2013). During that five year period, the prime rate of interest has consistently remained at 3.25% (the rate increased to 3.50% on December 17, 2015). The consistency of the net interest margin is aided by the relatively low level of long-term interest rate exposure that we maintain. At December 31, 2015, approximately 76% of our interest-earning assets are subject to repricing within five years (because they are either adjustable rate assets or they are fixed rate assets that mature) and substantially all of our interest-bearing liabilities reprice within five years.

Table 17 sets forth our interest rate sensitivity analysis as of December 31, 2015, using stated maturities for all fixed rate instruments except mortgage-backed securities (which are allocated in the periods of their expected payback) and securities and borrowings with call features that are expected to be called (which are shown in the period of their expected call). As illustrated by this table, at December 31, 2015, we had \$961 million more in interest-bearing liabilities that are subject to interest rate changes within one year than earning assets. This generally would indicate that net interest income would experience downward pressure in a rising interest rate environment and would benefit from a declining interest rate environment. However, this method of analyzing interest sensitivity only measures the magnitude of the timing differences and does not address earnings, market value, or management actions. Also, interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. In addition to the effects of “when” various rate-sensitive products reprice, market rate changes may not result in uniform changes in rates among all products. For example, included in interest-bearing liabilities subject to interest rate changes within one year at December 31, 2015 are deposits totaling \$1.45 billion comprised of checking, savings, and certain types of money market deposits with interest rates set by management. These types of deposits historically have not repriced with, or in the same proportion, as general market indicators.

Overall, we believe that in the near term (twelve months), net interest income will not likely experience significant downward pressure from rising interest rates. Similarly, we would not expect a significant increase in near term net interest income from falling interest rates. Generally, when rates change, our interest-sensitive assets that are subject to adjustment reprice immediately at the full amount of the change, while our interest-sensitive liabilities that are subject to adjustment reprice at a lag to the rate change and typically not to the full extent of the rate change. In the short-term (less than six months), this results in us being asset-sensitive, meaning that our net interest income benefits from an increase in interest rates and is negatively impacted by a decrease in interest rates. However, in the twelve-month horizon, the impact of having a higher level of interest-sensitive liabilities lessens the short-term effects of changes in interest rates.



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The general discussion in the foregoing paragraph applies most directly in a “normal” interest rate environment in which longer-term maturity instruments carry higher interest rates than short-term maturity instruments, and is less applicable in periods in which there is a “flat” interest rate curve. A “flat yield curve” means that short-term interest rates are substantially the same as long-term interest rates. As a result of the prolonged negative/fragile economic environment, the Federal Reserve took steps to suppress long-term interest rates in an effort to boost the housing market, increase employment, and stimulate the economy, which resulted in a flat interest rate curve. A flat interest rate curve is an unfavorable interest rate environment for many banks, including the Company, as short-term interest rates generally drive our deposit pricing and longer-term interest rates generally drive loan pricing. When these rates converge, the profit spread we realize between loan yields and deposit rates narrows, which pressures our net interest margin.

While there have been periods in the last few years that the yield curve has steepened somewhat, it currently remains relatively flat. This flat yield curve and the intense competition for high-quality loans in our market areas have limited our ability to charge higher rates on loans, and thus we continue to experience downward pressure on our loan yields and net interest margin.

As it relates to deposits, the Federal Reserve made no changes to the short term interest rates it sets directly from 2008 until mid-December 2015, and since that time we have been able to reprice many of our maturing time deposits at lower interest rates. We have also been able to generally decrease the rates we paid on other categories of deposits as a result of declining short-term interest rates in the marketplace and an increase in liquidity that lessened our need to offer premium interest rates. However, as short-term rates are already near zero and with the Federal Reserve recently increasing short-term interest rates by 25 bps, it is unlikely that we will be able to continue the trend of reducing our funding costs in the same proportion as experienced in recent years.

As previously discussed in the section “Net Interest Income,” our net interest income has been impacted by certain purchase accounting adjustments related primarily to our acquisitions of Cooperative Bank and The Bank of Asheville. The purchase accounting adjustments related to the premium amortization on loans, deposits and borrowings are based on amortization schedules and are thus systematic and predictable. The accretion of the loan discount on loans acquired from Cooperative Bank and The Bank of Asheville, which amounted to \$4.8 million and \$16.0 million for 2015 and 2014, respectively, is less predictable and can be materially different among periods. This is because of the magnitude of the discounts that were initially recorded (\$280 million in total) and the fact that the accretion being recorded is dependent on both the credit quality of the acquired loans and the impact of any accelerated loan repayments, including payoffs. If the credit quality of the loans declines, some, or all, of the remaining discount will cease to be accreted into income. If the underlying loans experience accelerated paydowns or improved performance expectations, the remaining discount will be accreted into income on an accelerated basis. In the event of total payoff, the remaining discount will be entirely accreted into income in the period of the payoff. Each of these factors is difficult to predict and susceptible to volatility. However, with the remaining loan discount on accruing loans having naturally declined since inception, amounting to only \$13.1 million at December 31, 2015 (compared to \$17.6 million a year earlier), we expect that loan discount accretion, and the related indemnification asset expense associated with the accretion, will again decline in 2016. If that occurs, our net interest margin will be negatively impacted and our noninterest income will be positively impacted (due to the lower indemnification asset expense).

Based on our most recent interest rate modeling, which assumes no changes in interest rates for 2016 (federal funds rate = 0.50%, prime = 3.50%), we project that our net interest margin for 2016 will experience additional compression. We expect loan yields to continue to trend downwards, while many of our deposit products already have interest rates near zero.

We have no market risk sensitive instruments held for trading purposes, nor do we maintain any foreign currency positions. Table 19 presents the expected maturities of our other than trading market risk sensitive financial instruments. Table 19 also presents the estimated fair values of market risk sensitive instruments as estimated in accordance with relevant accounting guidance. Our assets and liabilities have estimated fair values that do not materially differ from their carrying amounts.

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See additional discussion regarding net interest income, as well as discussion of the changes in the annual net interest margin, in the section entitled “Net Interest Income” above.

**Inflation**

Because the assets and liabilities of a bank are primarily monetary in nature (payable in fixed determinable amounts), the performance of a bank is affected more by changes in interest rates than by inflation. Interest rates generally increase as the rate of inflation increases, but the magnitude of the change in rates may not be the same. The effect of inflation on banks is normally not as significant as its influence on those businesses that have large investments in plant and inventories. During periods of high inflation, there are normally corresponding increases in the money supply, and banks will normally experience above average growth in assets, loans and deposits. Also, general increases in the price of goods and services will result in increased operating expenses.

**Current Accounting Matters**

We prepare our consolidated financial statements and related disclosures in conformity with standards established by, among others, the Financial Accounting Standards Board (the “FASB”). Because the information needed by users of financial reports is dynamic, the FASB frequently issues new rules and proposes new rules for companies to apply in reporting their activities. See Note 1(u) to our consolidated financial statements for a discussion of recent rule proposals and changes.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

The information responsive to this Item is found in Item 7 under the caption “Interest Rate Risk.”

Table of Contents**Table 1 Selected Consolidated Financial Data**

| (\$ in thousands, except per share<br>and nonfinancial data) | Year Ended December 31, |           |           |           |           |
|--|-------------------------|-----------|-----------|-----------|-----------|
|  | 2015                    | 2014      | 2013      | 2012      | 2011      |
| <b>Income Statement Data</b>                                 |                         |           |           |           |           |
| Interest income  | \$ 126,655              | 139,832   | 147,511   | 152,520   | 155,768   |
| Interest expense   | 6,908                   | 8,223     | 10,985    | 17,320    | 23,565    |
| Net interest income  | 119,747                 | 131,609   | 136,526   | 135,200   | 132,203   |
| Provision (reversal) for loan losses                         | (780 )                  | 10,195    | 30,616    | 79,672    | 41,301    |
| Net interest income after provision                          | 120,527                 | 121,414   | 105,910   | 55,528    | 90,902    |
| Noninterest income   | 18,764                  | 14,368    | 23,489    | 1,389     | 26,216    |
| Noninterest expense  | 98,131                  | 97,251    | 96,619    | 97,275    | 96,106    |
| Income (loss) before income taxes                            | 41,160                  | 38,531    | 32,780    | (40,358 ) | 21,012    |
| Income taxes (benefit)                                       | 14,126                  | 13,535    | 12,081    | (16,952 ) | 7,370     |
| Net income (loss)  | 27,034                  | 24,996    | 20,699    | (23,406 ) | 13,642    |
| Preferred stock dividends                                    | (603 )                  | (868 )    | (895 )    | (2,809 )  | (3,234 )  |
| Accretion of preferred stock discount                        | —                       | —         | —         | —         | (2,932 )  |
| Net income (loss) available to common shareholders           | 26,431                  | 24,128    | 19,804    | (26,215 ) | 7,476     |
| <br>   |                         |           |           |           |           |
| Earnings (loss) per common share – basic                     | 1.34                    | 1.22      | 1.01      | (1.54 )   | 0.44      |
| Earnings (loss) per common share – diluted                   | 1.30                    | 1.19      | 0.98      | (1.54 )   | 0.44      |
| <br>   |                         |           |           |           |           |
| <b>Per Share Data (Common)</b>                               |                         |           |           |           |           |
| Cash dividends declared – common                             | \$0.32                  | 0.32      | 0.32      | 0.32      | 0.32      |
| <b>Market Price</b>  |                         |           |           |           |           |
| High   | 19.92                   | 19.65     | 17.39     | 13.40     | 16.89     |
| Low  | 15.00                   | 15.55     | 11.98     | 7.68      | 8.05      |
| Close  | 18.74                   | 18.47     | 16.62     | 12.82     | 11.15     |
| Stated book value – common                                   | 16.96                   | 16.08     | 15.30     | 14.51     | 16.66     |
| Tangible book value – common                                 | 13.56                   | 12.63     | 11.81     | 11.00     | 12.53     |
| <br>   |                         |           |           |           |           |
| <b>Selected Balance Sheet Data (at year end)</b>             |                         |           |           |           |           |
| Total assets   | \$3,362,065             | 3,218,383 | 3,185,070 | 3,244,910 | 3,290,474 |
| Loans – non-covered  | 2,416,285               | 2,268,580 | 2,252,885 | 2,094,143 | 2,069,152 |
| Loans – covered  | 102,641                 | 127,594   | 210,309   | 282,314   | 361,234   |
| Total loans  | 2,518,926               | 2,396,174 | 2,463,194 | 2,376,457 | 2,430,386 |
| Allowance for loan losses                                    | 28,583                  | 40,626    | 48,505    | 46,402    | 41,418    |
| Intangible assets  | 67,171                  | 67,893    | 68,669    | 68,943    | 69,732    |
| Deposits   | 2,811,285               | 2,695,906 | 2,751,019 | 2,821,360 | 2,755,037 |
| Borrowings   | 186,394                 | 116,394   | 46,394    | 46,394    | 133,925   |
| Total shareholders' equity                                   | 342,190                 | 387,699   | 371,922   | 356,117   | 345,150   |

## Selected Average Balances

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|                              |             |           |           |           |           |
|------------------------------|-------------|-----------|-----------|-----------|-----------|
| Assets                       | \$3,230,302 | 3,219,915 | 3,208,458 | 3,311,289 | 3,315,045 |
| Loans – non-covered          | 2,320,503   | 2,274,554 | 2,175,023 | 2,114,489 | 2,051,677 |
| Loans – covered              | 114,099     | 159,777   | 244,656   | 322,508   | 410,318   |
| Total loans                  | 2,434,602   | 2,434,331 | 2,419,679 | 2,436,997 | 2,461,995 |
| Earning assets               | 2,936,624   | 2,907,098 | 2,805,112 | 2,857,541 | 2,834,938 |
| Deposits                     | 2,687,381   | 2,723,758 | 2,779,032 | 2,809,357 | 2,758,022 |
| Interest-bearing liabilities | 2,218,246   | 2,294,330 | 2,380,747 | 2,553,175 | 2,606,450 |
| Shareholders' equity         | 376,287     | 383,055   | 362,770   | 345,981   | 353,588   |

Ratios

|  |        |        |        |          |        |
|--|--------|--------|--------|----------|--------|
| Return on average assets                               | 0.82%  | 0.75%  | 0.62%  | (0.79% ) | 0.23%  |
| Return on average common equity                        | 8.04%  | 7.73%  | 6.78%  | (9.29% ) | 2.59%  |
| Net interest margin (taxable-equivalent basis)         | 4.13%  | 4.58%  | 4.92%  | 4.78%    | 4.72%  |
| Tangible common equity to tangible assets              | 8.13%  | 7.90%  | 7.46%  | 6.81%    | 6.58%  |
| Loans to deposits at year end                          | 89.60% | 88.88% | 89.54% | 84.23%   | 88.22% |
| Allowance for loan losses to total loans               | 1.13%  | 1.70%  | 1.97%  | 1.95%    | 1.70%  |
| Allowance for loan losses to total loans – non-covered | 1.11%  | 1.69%  | 1.96%  | 1.99%    | 1.72%  |
| Nonperforming assets to total assets at year end       | 2.66%  | 3.54%  | 4.79%  | 6.24%    | 8.00%  |
| Nonperforming assets to total assets – non-covered     | 2.37%  | 3.09%  | 2.78%  | 3.64%    | 4.30%  |
| Net charge-offs to average total loans                 | 0.46%  | 0.74%  | 1.18%  | 3.06%    | 2.00%  |
| Net charge-offs to average total loans – non-covered   | 0.58%  | 0.65%  | 0.72%  | 3.02%    | 1.52%  |

|  |     |     |     |     |     |
|--|-----|-----|-----|-----|-----|
| Nonfinancial Data – number of branches         | 88  | 87  | 96  | 97  | 97  |
| Nonfinancial Data – number of employees (FTEs) | 812 | 798 | 855 | 831 | 830 |

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Table of Contents**Table 2 Average Balances and Net Interest Income Analysis**

|  | Year Ended December 31, |              |                               |                   |              |                               |                   |              |  |
|--|-------------------------|--------------|-------------------------------|-------------------|--------------|-------------------------------|-------------------|--------------|--|
|  | 2015                    |              |                               | 2014              |              |                               | 2013              |              |  |
|  | Average<br>Volume       | Avg.<br>Rate | Interest<br>Earned<br>or Paid | Average<br>Volume | Avg.<br>Rate | Interest<br>Earned<br>or Paid | Average<br>Volume | Avg.<br>Rate |  |
| <i>(\$ in thousands)</i>   |                         |              |                               |                   |              |                               |                   |              |  |
| <b>Assets</b>  |                         |              |                               |                   |              |                               |                   |              |  |
| Loans (1) (2)  | \$2,434,602             | 4.84%        | \$117,872                     | \$2,434,331       | 5.49%        | \$133,641                     | \$2,419,679       | 5.85%        |  |
| Taxable securities   | 296,181                 | 2.13%        | 6,296                         | 167,844           | 2.06%        | 3,461                         | 175,184           | 1.95%        |  |
| Non-taxable securities (3)                                       | 52,449                  | 6.60%        | 3,463                         | 53,888            | 6.28%        | 3,383                         | 54,785            | 6.22%        |  |
| Short-term investments,<br>primarily overnight funds             | 153,392                 | 0.43%        | 658                           | 251,035           | 0.34%        | 849                           | 155,464           | 0.38%        |  |
| Total interest-<br>earning assets                                | 2,936,624               | 4.37%        | 128,289                       | 2,907,098         | 4.86%        | 141,334                       | 2,805,112         | 5.31%        |  |
| Cash and due from banks  | 61,212                  |              |                               | 81,290            |              |                               | 80,659            |              |  |
| Bank premises and<br>equipment, net                              | 75,452                  |              |                               | 76,463            |              |                               | 77,252            |              |  |
| Other assets   | 157,014                 |              |                               | 155,064           |              |                               | 245,435           |              |  |
| Total assets   | \$3,230,302             |              |                               | \$3,219,915       |              |                               | \$3,208,458       |              |  |
| <b>Liabilities and Equity</b>                                    |                         |              |                               |                   |              |                               |                   |              |  |
| Interest-bearing checking accounts                               | \$568,329               | 0.06%        | \$335                         | \$535,738         | 0.06%        | \$322                         | \$530,566         | 0.09%        |  |
| Money market accounts  | 582,407                 | 0.13%        | 765                           | 552,940           | 0.11%        | 630                           | 560,809           | 0.16%        |  |
| Savings accounts   | 184,821                 | 0.05%        | 92                            | 176,362           | 0.05%        | 88                            | 166,388           | 0.07%        |  |
| Time deposits >\$100,000   | 410,692                 | 0.70%        | 2,856                         | 542,303           | 0.81%        | 4,373                         | 607,028           | 0.96%        |  |
| Other time deposits  | 322,205                 | 0.39%        | 1,271                         | 387,607           | 0.43%        | 1,659                         | 469,562           | 0.56%        |  |
| Total interest-bearing deposits                                  | 2,068,454               | 0.26%        | 5,319                         | 2,194,950         | 0.32%        | 7,072                         | 2,334,353         | 0.43%        |  |
| Borrowings   | 149,792                 | 1.06%        | 1,589                         | 99,380            | 1.16%        | 1,151                         | 46,394            | 2.21%        |  |
| Total interest-<br>bearing liabilities                           | 2,218,246               | 0.31%        | 6,908                         | 2,294,330         | 0.36%        | 8,223                         | 2,380,747         | 0.46%        |  |
| Noninterest-bearing checking accounts                            | 618,927                 |              |                               | 528,808           |              |                               | 444,679           |              |  |
| Other liabilities  | 16,842                  |              |                               | 13,722            |              |                               | 20,262            |              |  |
| Shareholders' equity   | 376,287                 |              |                               | 383,055           |              |                               | 362,770           |              |  |
| Total liabilities and<br>shareholders' equity                    | \$3,230,302             |              |                               | \$3,219,915       |              |                               | \$3,208,458       |              |  |
| Net yield on interest-<br>earning assets and net interest income |                         | 4.13%        | \$121,381                     |                   | 4.58%        | \$133,111                     |                   | 4.92%        |  |
| Interest rate spread   |                         | 4.06%        |                               |                   | 4.50%        |                               |                   | 4.85%        |  |
| Average prime rate   |                         | 3.26%        |                               |                   | 3.25%        |                               |                   | 3.25%        |  |

Average loans include nonaccruing loans, the effect of which is to lower the average rate shown. Interest earned (1) includes recognized net loan fees (costs) in the amounts of (\$39,000), \$143,700, and (\$192,900) for 2015, 2014, and 2013, respectively.

(2)

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Includes accretion of discount on covered loans of \$4,751,000, \$16,009,000, and \$20,200,000 in 2015, 2014, and 2013, respectively.

Includes tax-equivalent adjustments of \$1,634,000, \$1,502,000, and \$1,511,000 in 2015, 2014, and 2013, (3) respectively, to reflect the federal and state tax benefit of the tax-exempt securities (using a 39% combined tax rate), reduced by the related nondeductible portion of interest expense.

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Table of Contents**Table 3 Volume and Rate Variance Analysis**

| (\$ in thousands)                                 | Year Ended December 31, 2015 |                  |                           | Year Ended December 31, 2014 |                  |                           |
|---|------------------------------|------------------|---------------------------|------------------------------|------------------|---------------------------|
|   | Change Attributable to       |                  | Total Increase (Decrease) | Change Attributable to       |                  | Total Increase (Decrease) |
|   | Changes in Volumes           | Changes in Rates |                           | Changes in Volumes           | Changes in Rates |                           |
| <b>Interest income (tax-equivalent):</b>          |                              |                  |                           |                              |                  |                           |
| Loans   | \$ 14                        | (15,783 )        | (15,769 )                 | 831                          | (8,806 )         | (7,975 )                  |
| Taxable securities                                | 2,687                        | 148              | 2,835                     | (147 )                       | 198              | 51                        |
| Non-taxable securities                            | (93 )                        | 173              | 80                        | (56 )                        | 29               | (27 )                     |
| Short-term investments, primarily overnight funds | (375 )                       | 184              | (191 )                    | 342                          | (79 )            | 263                       |
| Total interest income                             | 2,233                        | (15,278 )        | (13,045 )                 | 970                          | (8,658 )         | (7,688 )                  |
| <b>Interest expense:</b>                          |                              |                  |                           |                              |                  |                           |
| Interest-bearing checking accounts                | 19                           | (6 )             | 13                        | 4                            | (158 )           | (154 )                    |
| Money market accounts                             | 36                           | 99               | 135                       | (11 )                        | (259 )           | (270 )                    |
| Savings accounts                                  | 4                            | —                | 4                         | 6                            | (35 )            | (29 )                     |
| Time deposits >\$100,000                          | (988 )                       | (529 )           | (1,517 )                  | (572 )                       | (880 )           | (1,452 )                  |
| Other time deposits                               | (269 )                       | (119 )           | (388 )                    | (406 )                       | (577 )           | (983 )                    |
| Total interest-bearing deposits                   | (1,198 )                     | (555 )           | (1,753 )                  | (979 )                       | (1,909 )         | (2,888 )                  |
| Borrowings  | 559                          | (121 )           | 438                       | 892                          | (766 )           | 126                       |
| Total interest expense                            | (639 )                       | (676 )           | (1,315 )                  | (87 )                        | (2,675 )         | (2,762 )                  |
| Net interest income (tax-equivalent)              | \$ 2,872                     | (14,602 )        | (11,730 )                 | 1,057                        | (5,983 )         | (4,926 )                  |

Changes attributable to both volume and rate are allocated equally between rate and volume variances.

**Table 4 Noninterest Income**

| (\$ in thousands)  | Year Ended December 31, |          |          |
|--|-------------------------|----------|----------|
|  | 2015                    | 2014     | 2013     |
| Service charges on deposit accounts                        | \$ 11,648               | 13,706   | 12,752   |
| Other service charges, commissions, and fees               | 10,906                  | 10,019   | 9,318    |
| Fees from presold mortgages                                | 2,532                   | 2,726    | 2,907    |
| Commissions from sales of insurance and financial products | 2,580                   | 2,733    | 2,132    |
| Bank owned life insurance income                           | 1,665                   | 1,311    | 1,120    |
| Total core noninterest income                              | 29,331                  | 30,495   | 28,229   |
| Foreclosed property gains (losses) – non-covered           | (2,504 )                | (1,924 ) | 1,333    |
| Foreclosed property gains (losses) – covered               | 1,018                   | (1,919 ) | 367      |
| FDIC Indemnification asset income (expense), net           | (8,615 )                | (12,842) | (6,824 ) |

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|                                |          |        |        |
|--------------------------------|----------|--------|--------|
| Securities gains (losses), net | (1 )     | 786    | 532    |
| Other gains (losses), net      | (465 )   | (228 ) | (148 ) |
| Total                          | \$18,764 | 14,368 | 23,489 |

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Table of Contents**Table 5 Noninterest Expenses**

| (\$ in thousands)  | Year Ended December 31, |        |        |
|--|-------------------------|--------|--------|
|  | 2015                    | 2014   | 2013   |
| Salaries   | \$47,660                | 46,071 | 45,120 |
| Employee benefits  | 9,134                   | 9,086  | 9,644  |
| Total personnel expense  | 56,794                  | 55,157 | 54,764 |
| Occupancy expense  | 7,358                   | 7,362  | 7,123  |
| Equipment related expenses   | 3,749                   | 3,931  | 4,364  |
| Amortization of intangible assets  | 722                     | 777    | 860    |
| FDIC insurance expense   | 2,394                   | 3,988  | 2,803  |
| Repossession and collection expenses – non-covered                         | 2,167                   | 2,092  | 2,216  |
| Repossession and collection expenses – covered, net of FDIC reimbursements | (54 )                   | (861 ) | 1,142  |
| Telephone and data lines   | 2,133                   | 1,988  | 1,489  |
| Stationery and supplies  | 2,039                   | 1,710  | 2,078  |
| Data processing expense  | 1,935                   | 1,654  | —      |
| Dues and subscription expense  | 1,710                   | 1,717  | 1,583  |
| Legal and audit  | 1,689                   | 1,955  | 1,204  |
| Outside consultants  | 1,677                   | 1,663  | 2,460  |
| Non-credit losses  | 360                     | 309    | 426    |
| Severance expenses   | 221                     | 512    | 1,895  |
| Branch consolidation expense   | —                       | 976    | —      |
| Other operating expenses   | 13,237                  | 12,321 | 12,212 |
| Total  | \$98,131                | 97,251 | 96,619 |

**Table 6 Income Taxes**

| (\$ in thousands)  | 2015     | 2014   | 2013   |
|--------------------|----------|--------|--------|
| Current - Federal  | \$9,149  | 1,316  | 9,812  |
| - State            | 1,436    | 903    | (467 ) |
| Deferred - Federal | 3,205    | 10,104 | 168    |
| - State            | 336      | 1,212  | 2,568  |
| Total tax expense  | \$14,126 | 13,535 | 12,081 |
| Effective tax rate | 34.3%    | 35.1%  | 36.9%  |

Table of Contents**Table 7 Distribution of Assets and Liabilities**

|  | As of December 31, |      |      |
|--|--------------------|------|------|
|  | 2015               | 2014 | 2013 |
| Assets                                     |                    |      |      |
| Interest-earning assets                    |                    |      |      |
| Net loans                                  | 74%                | 73%  | 76%  |
| Securities available for sale              | 5                  | 5    | 6    |
| Securities held to maturity                | 5                  | 6    | 2    |
| Short term investments                     | 7                  | 5    | 4    |
| Total interest-earning assets              | 91                 | 89   | 88   |
| Noninterest-earning assets                 |                    |      |      |
| Cash and due from banks                    | 2                  | 3    | 3    |
| Premises and equipment                     | 2                  | 2    | 2    |
| FDIC indemnification asset                 | —                  | 1    | 2    |
| Intangible assets                          | 2                  | 2    | 2    |
| Foreclosed real estate                     | —                  | —    | 1    |
| Bank-owned life insurance                  | 2                  | 2    | 1    |
| Other assets                               | 1                  | 1    | 1    |
| Total assets                               | 100%               | 100% | 100% |
| Liabilities and shareholders' equity       |                    |      |      |
| Noninterest-bearing checking accounts      | 20%                | 17%  | 15%  |
| Interest-bearing checking accounts         | 19                 | 18   | 18   |
| Money market accounts                      | 19                 | 17   | 17   |
| Savings accounts                           | 5                  | 6    | 5    |
| Time deposits of \$100,000 or more         | 12                 | 15   | 18   |
| Other time deposits                        | 9                  | 11   | 13   |
| Total deposits                             | 84                 | 84   | 86   |
| Borrowings                                 | 5                  | 4    | 1    |
| Accrued expenses and other liabilities     | 1                  | —    | 1    |
| Total liabilities                          | 90                 | 88   | 88   |
| Shareholders' equity                       | 10                 | 12   | 12   |
| Total liabilities and shareholders' equity | 100%               | 100% | 100% |

**Table 8 Securities Portfolio Composition**

|  | As of December 31, |         |         |
|--|--------------------|---------|---------|
| (\$ in thousands)                          | 2015               | 2014    | 2013    |
| Securities available for sale:             |                    |         |         |
| Government-sponsored enterprise securities | \$ 18,972          | 27,521  | 18,245  |
| Mortgage-backed securities                 | 121,553            | 129,510 | 147,187 |
| Corporate bonds                            | 24,946             | 865     | 3,598   |

|                                      |           |         |         |
|--------------------------------------|-----------|---------|---------|
| Equity securities                    | 143       | 122     | 117     |
| Total securities available for sale  | 165,614   | 158,018 | 169,147 |
| Securities held to maturity:         |           |         |         |
| Mortgage-backed securities           | 102,509   | 124,924 | —       |
| State and local governments          | 52,101    | 53,763  | 53,995  |
| Total securities held to maturity    | 154,610   | 178,687 | 53,995  |
| Total securities                     | \$320,224 | 336,705 | 223,142 |
| Average total securities during year | \$348,630 | 221,732 | 229,969 |

Table of Contents**Table 9 Securities Portfolio Maturity Schedule**

| (\$ in thousands)                          | As of December 31,<br>2015 |               |                   |
|--|----------------------------|---------------|-------------------|
|  | Book<br>Value              | Fair<br>Value | Book<br>Yield (1) |
| Securities available for sale:             |                            |               |                   |
| Government-sponsored enterprise securities |                            |               |                   |
| Due after one but within five years        | \$ 19,000                  | 18,972        | 1.85%             |
| Total                                      | 19,000                     | 18,972        | 1.85%             |
| Mortgage-backed securities (2)             |                            |               |                   |
| Due within one year                        | 500                        | 513           | 2.25%             |
| Due after one but within five years        | 75,702                     | 75,389        | 1.90%             |
| Due after five but within ten years        | 41,023                     | 40,401        | 2.00%             |
| Due after ten years                        | 5,249                      | 5,250         | 3.37%             |
| Total                                      | 122,474                    | 121,553       | 2.00%             |
| Corporate debt securities                  |                            |               |                   |
| Due after five but within ten years        | 20,216                     | 20,026        | 3.20%             |
| Due after ten years                        | 5,000                      | 4,920         | 5.35%             |
| Total                                      | 25,216                     | 24,946        | 3.63%             |
| Equity securities                          | 88                         | 143           | 2.05%             |
| Total securities available for sale        |                            |               |                   |
| Due within one year                        | 500                        | 513           | 2.25%             |
| Due after one but within five years        | 94,702                     | 94,361        | 1.89%             |
| Due after five but within ten years        | 61,239                     | 60,427        | 2.40%             |
| Due after ten years                        | 10,249                     | 10,170        | 4.34%             |
| Equity securities                          | 88                         | 143           | 2.05%             |
| Total                                      | \$ 166,778                 | 165,614       | 2.23%             |
| Securities held to maturity:               |                            |               |                   |
| Mortgage-backed securities (2)             |                            |               |                   |
| Due after one but within five years        | \$ 76,289                  | 75,720        | 1.88%             |
| Due after five but within ten years        | 26,220                     | 26,047        | 2.46%             |
| Total                                      | 102,509                    | 101,767       | 2.03%             |
| State and local governments                |                            |               |                   |
| Due within one year                        | 835                        | 839           | 5.58%             |
| Due after one but within five years        | 12,549                     | 13,190        | 5.54%             |
| Due after five but within ten years        | 37,286                     | 39,919        | 5.69%             |



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|                                     |           |         |       |
|-------------------------------------|-----------|---------|-------|
| Due after ten years                 | 1,431     | 1,431   | 4.52% |
| Total securities held to maturity   | 52,101    | 55,379  | 5.62% |
| Total securities held to maturity   |           |         |       |
| Due within one year                 | 835       | 839     | 5.58% |
| Due after one but within five years | 88,838    | 88,910  | 2.40% |
| Due after five but within ten years | 63,506    | 65,966  | 4.36% |
| Due after ten years                 | 1,431     | 1,431   | 4.52% |
| Total                               | \$154,610 | 157,146 | 3.24% |

- (1) Yields on tax-exempt investments have been adjusted to a taxable equivalent basis using a 39% tax rate.
- (2) Mortgage-backed securities are shown maturing in the periods consistent with their estimated lives based on expected prepayment speeds.

Table of Contents**Table 10 Loan Portfolio Composition**

| (\$ in thousands)   | As of December 31,<br>2015 |                        | 2014        |                        | 2013        |                        |
|---|----------------------------|------------------------|-------------|------------------------|-------------|------------------------|
|   | Amount                     | % of<br>Total<br>Loans | Amount      | % of<br>Total<br>Loans | Amount      | % of<br>Total<br>Loans |
| Commercial, financial, and agricultural                           | \$202,671                  | 8%                     | \$160,878   | 7%                     | \$168,469   | 7%                     |
| Real estate – construction, land development & other land loans   | 308,969                    | 12%                    | 288,148     | 12%                    | 305,246     | 12%                    |
| Real estate – mortgage – residential (1-4 family) first mortgages | 768,559                    | 31%                    | 789,871     | 33%                    | 838,862     | 34%                    |
| Real estate – mortgage – home equity loans / lines of credit      | 232,601                    | 9%                     | 223,500     | 9%                     | 227,907     | 9%                     |
| Real estate – mortgage – commercial and other                     | 957,587                    | 38%                    | 882,127     | 37%                    | 855,249     | 35%                    |
| Installment loans to individuals                                  | 47,666                     | 2%                     | 50,704      | 2%                     | 66,533      | 3%                     |
| Loans, gross  | 2,518,053                  | 100%                   | 2,395,228   | 100%                   | 2,462,266   | 100%                   |
| Unamortized net deferred loan costs                               | 873                        |                        | 946         |                        | 928         |                        |
| Total loans (1)   | \$2,518,926                |                        | \$2,396,174 |                        | \$2,463,194 |                        |

(1) Excludes loans held for sale at December 31, 2012

**Table 10a Loan Portfolio Composition – Covered versus Non-covered**

As of December 31, 2015

| (\$ in thousands)   | Covered Loans<br>(Carrying Value) |                          | Non-covered Loans |                                  | Total Loans |                        |
|---|-----------------------------------|--------------------------|-------------------|----------------------------------|-------------|------------------------|
|   | Amount                            | % of<br>Covered<br>Loans | Amount            | % of<br>Non-<br>covered<br>Loans | Amount      | % of<br>Total<br>Loans |
| Commercial, financial, and agricultural                           | \$873                             | 1%                       | \$201,798         | 8%                               | \$202,671   | 8%                     |
| Real estate – construction, land development & other land loans   | 3,741                             | 4%                       | 305,228           | 13%                              | 308,969     | 12%                    |
| Real estate – mortgage – residential (1-4 family) first mortgages | 75,657                            | 74%                      | 692,902           | 29%                              | 768,559     | 31%                    |
| Real estate – mortgage – home equity loans / lines of credit      | 10,606                            | 10%                      | 221,995           | 9%                               | 232,601     | 9%                     |
| Real estate – mortgage – commercial and other                     | 11,764                            | 11%                      | 945,823           | 39%                              | 957,587     | 38%                    |
| Installment loans to individuals                                  | —                                 | —                        | 47,666            | 2%                               | 47,666      | 2%                     |
| Loans, gross  | 102,641                           | 100%                     | 2,415,412         | 100%                             | 2,518,053   | 100%                   |
| Unamortized net deferred loan costs                               | —                                 |                          | 873               |                                  | 873         |                        |
| Total loans   | \$102,641                         |                          | \$2,416,285       |                                  | \$2,518,926 |                        |

See Note 4 to the Consolidated Financial Statements for tables showing breakout of covered loans versus non-covered loans at 81

Table of Contents**Table 11 Loan Maturities**

| (\$ in thousands)                                    | As of December 31, 2015 |       |  |       |                      |        | Total       |
|--|-------------------------|-------|--|-------|----------------------|--------|-------------|
|  | Due within one year     |       | Due after one year but within five years |       | Due after five years |        |             |
|  | Amount                  | Yield | Amount                                   | Yield | Amount               | Yield  |             |
| <b>Variable Rate Loans:</b>                          |                         |       |  |       |                      |        |             |
| Commercial, financial, and agricultural              | \$46,665                | 4.37% | \$11,546                                 | 5.16% | \$18,173             | 2.47%  | \$76,384    |
| Real estate – construction only                      | 32,370                  | 4.90% | 28,835                                   | 3.90% | 14,859               | 3.05%  | 76,064      |
| Real estate – all other mortgage                     | 93,106                  | 5.06% | 157,648                                  | 4.92% | 176,518              | 3.71%  | 427,272     |
| Real estate – home equity loans/ line of credit      | 5,828                   | 4.30% | 30,126                                   | 4.10% | 180,214              | 3.82%  | 216,168     |
| Consumer, primarily installment loans to individuals | 1,218                   | 4.48% | 21,016                                   | 8.34% | 6,532                | 5.77%  | 27,766      |
| Total at variable rates                              | 179,187                 | 4.82% | 249,171                                  | 5.00% | 396,296              | 3.71%  | 824,654     |
| <b>Fixed Rate Loans:</b>                             |                         |       |  |       |                      |        |             |
| Commercial, financial, and agricultural              | 17,609                  | 5.02% | 78,741                                   | 4.31% | 24,874               | 2.93%  | 121,224     |
| Real estate – construction only                      | 41,462                  | 3.46% | 15,309                                   | 4.42% | 25,659               | 4.17%  | 82,430      |
| Real estate – all other mortgage                     | 109,128                 | 5.45% | 728,941                                  | 4.96% | 583,782              | 4.19%  | 1,421,851   |
| Consumer, primarily installment loans to individuals | 3,437                   | 6.10% | 13,205                                   | 6.17% | 4,315                | 14.56% | 21,057      |
| Total at fixed rates                                 | 171,636                 | 4.94% | 836,196                                  | 4.91% | 638,630              | 4.21%  | 1,646,462   |
| Subtotal   | 350,823                 | 4.88% | 1,085,367                                | 4.93% | 1,034,926            | 4.02%  | 2,471,116   |
| Nonaccrual loans                                     | 47,810                  |       | —  |       | —                    |        | 47,810      |
| Total loans  | \$398,633               |       | \$1,085,367                              |       | \$1,034,926          |        | \$2,518,926 |

The above table is based on contractual scheduled maturities. Early repayment of loans or renewals at maturity are not considered in this table.

Table of Contents**Table 12 Nonperforming Assets**

| (\$ in thousands)  | As of December 31, |         |         |
|--|--------------------|---------|---------|
|  | 2015               | 2014    | 2013    |
| Non-covered nonperforming assets (1)   |                    |         |         |
| Nonaccrual loans   | \$39,994           | 50,066  | 41,933  |
| Restructured loans - accruing  | 28,011             | 35,493  | 27,770  |
| Accruing loans >90 days past due   | —                  | —       | —       |
| Total non-covered nonperforming loans  | 68,005             | 85,559  | 69,711  |
| Nonperforming loans held for sale  | —                  | —       | —       |
| Foreclosed real estate   | 9,188              | 9,771   | 12,250  |
| Total non-covered nonperforming assets   | \$77,193           | 95,330  | 81,961  |
| Covered nonperforming assets (1)   |                    |         |         |
| Nonaccrual loans (2)   | \$7,816            | 10,508  | 37,211  |
| Restructured loans - accruing  | 3,478              | 5,823   | 8,909   |
| Accruing loans >90 days past due   | —                  | —       | —       |
| Total covered nonperforming loans  | 11,294             | 16,331  | 46,120  |
| Foreclosed real estate   | 806                | 2,350   | 24,490  |
| Total covered nonperforming assets   | \$12,100           | 18,681  | 70,610  |
| Total nonperforming assets   | \$89,293           | 114,011 | 152,571 |
| Asset Quality Ratios – All Assets  |                    |         |         |
| Nonperforming loans to total loans   | 3.15%              | 4.25%   | 4.70%   |
| Nonperforming assets to total loans and foreclosed real estate                               | 3.53%              | 4.73%   | 6.10%   |
| Nonperforming assets to total assets   | 2.66%              | 3.54%   | 4.79%   |
| Asset Quality Ratios – Based on Non-covered Assets only                                      |                    |         |         |
| Non-covered nonperforming loans to non-covered loans   | 2.81%              | 3.77%   | 3.09%   |
| Non-covered nonperforming assets to non-covered loans and non-covered foreclosed real estate | 3.18%              | 4.18%   | 3.62%   |
| Non-covered nonperforming assets to total non-covered assets                                 | 2.37%              | 3.09%   | 2.78%   |

(1) Covered nonperforming assets consist of assets that are included in loss share agreements with the FDIC. On July 1, 2014, approximately \$9.7 million of nonaccrual loans, \$2.1 million accruing restructured loans and \$3.0 million of foreclosed real estate were transferred from covered to noncovered status upon a scheduled expiration of a FDIC loss-share agreement.

(2) At December 31, 2015, 2014 and 2013, the contractual balance of the nonaccrual loans covered by the FDIC loss share agreement was \$12.3 million, \$16.0 million and \$60.4 million, respectively.

Table of Contents**Table 12a Nonperforming Assets by Geographical Region**

| (\$ in thousands)  | As of December 31, 2015 |             |        | Total<br>Loans | Nonperforming<br>Loans to<br>Total<br>Loans |
|--|-------------------------|-------------|--------|----------------|---|
|  | Covered                 | Non-covered | Total  |                |   |
| <b>Nonaccrual loans and Troubled Debt Restructurings (1)</b> |                         |             |        |                |   |
| Eastern Region (NC)  | \$7,793                 | 15,479      | 23,272 | 646,000        | 3.6%  |
| Triangle Region (NC)   | —                       | 19,694      | 19,694 | 744,000        | 2.6%  |
| Triad Region (NC)  | —                       | 14,514      | 14,514 | 334,000        | 4.3%  |
| Charlotte Region (NC)  | —                       | 1,892       | 1,892  | 98,000         | 1.9%  |
| Southern Piedmont Region (NC)                                | 38                      | 6,692       | 6,730  | 268,000        | 2.5%  |
| Western Region (NC)  | 3,435                   | —           | 3,435  | 87,000         | 3.9%  |
| South Carolina Region  | 28                      | 2,410       | 2,438  | 123,000        | 2.0%  |
| Virginia Region  | —                       | 7,324       | 7,324  | 194,000        | 3.8%  |
| Other  | —                       | —           | —      | 25,000         | 0.0%  |
| Total nonaccrual loans and troubled debt restructurings      | \$11,294                | 68,005      | 79,299 | 2,519,000      | 3.2%  |
| <b>Foreclosed Real Estate (1)</b>                            |                         |             |        |                |   |
| Eastern Region (NC)  | \$512                   | 1,498       | 2,010  |                |   |
| Triangle Region (NC)   | —                       | 3,090       | 3,090  |                |   |
| Triad Region (NC)  | —                       | 917         | 917    |                |   |
| Charlotte Region (NC)  | —                       | 858         | 858    |                |   |
| Southern Piedmont Region (NC)                                | —                       | 1,059       | 1,059  |                |   |
| Western Region (NC)  | 294                     | —           | 294    |                |   |
| South Carolina Region  | —                       | 699         | 699    |                |   |
| Virginia Region  | —                       | 1,067       | 1,067  |                |   |
| Other  | —                       | —           | —      |                |   |
| Total foreclosed real estate                                 | \$806                   | 9,188       | 9,994  |                |   |

(1) The counties comprising each region are as follows:

Eastern North Carolina Region - New Hanover, Brunswick, Duplin, Dare, Beaufort, Pitt, Onslow, Carteret

Triangle North Carolina Region - Moore, Lee, Harnett, Chatham, Wake

Triad North Carolina Region - Montgomery, Randolph, Davidson, Rockingham, Guilford, Stanly

Charlotte North Carolina Region - Iredell, Cabarrus, Mecklenburg, Rowan

Southern Piedmont North Carolina Region - Anson, Richmond, Scotland, Robeson, Bladen, Columbus, Cumberland

Western North Carolina Region - Buncombe

South Carolina Region - Chesterfield, Dillon, Florence

Virginia Region - Wythe, Washington, Montgomery, Roanoke

Table of Contents**Table 13 Allocation of the Allowance for Loan Losses**

| (\$ in thousands)   | As of December 31, |        |        |        |        |
|---|--------------------|--------|--------|--------|--------|
|   | 2015               | 2014   | 2013   | 2012   | 2011   |
| Commercial, financial, and agricultural                         | \$4,780            | 8,533  | 8,635  | 4,855  | 4,443  |
| Real estate – construction, land development                    | 3,446              | 6,832  | 14,064 | 14,103 | 14,268 |
| Real estate – residential, commercial, home equity, multifamily | 18,623             | 24,244 | 24,439 | 24,554 | 20,818 |
| Installment loans to individuals                                | 1,038              | 841    | 1,519  | 1,942  | 1,873  |
| Total allocated   | 27,887             | 40,450 | 48,657 | 45,454 | 41,402 |
| Unallocated   | 696                | 176    | (152 ) | 948    | 16     |
| Total   | \$28,583           | 40,626 | 48,505 | 46,402 | 41,418 |

**Table 13a Allocation of the Allowance for Loan Losses – Covered versus Non-covered**

| (\$ in thousands)   | As of December 31, 2015 |             |        | As of December 31, 2014 |             |        |
|---|-------------------------|-------------|--------|-------------------------|-------------|--------|
|   | Covered                 | Non-covered | Total  | Covered                 | Non-covered | Total  |
| Commercial, financial, and agricultural                         | \$22                    | 4,758       | 4,780  | 142                     | 8,391       | 8,533  |
| Real estate – construction, land development                    | 36                      | 3,410       | 3,446  | 362                     | 6,470       | 6,832  |
| Real estate – residential, commercial, home equity, multifamily | 1,741                   | 16,882      | 18,623 | 1,748                   | 22,496      | 24,244 |
| Installment loans to individuals                                | —                       | 1,038       | 1,038  | —                       | 841         | 841    |
| Total allocated   | 1,799                   | 26,088      | 27,887 | 2,252                   | 38,198      | 40,450 |
| Unallocated   | —                       | 696         | 696    | 29                      | 147         | 176    |
| Total   | \$1,799                 | 26,784      | 28,583 | 2,281                   | 38,345      | 40,626 |

Table of Contents**Table 14 Loan Loss and Recovery Experience**

| (\$ in thousands)  | As of December 31, |           |           |           |
|--|--------------------|-----------|-----------|-----------|
|  | 2015               | 2014      | 2013      | 2012      |
| Loans outstanding at end of year   | \$2,518,926        | 2,396,174 | 2,463,194 | 2,311,194 |
| Average amount of loans outstanding  | \$2,434,602        | 2,434,331 | 2,419,679 | 2,434,331 |
| Allowance for loan losses, at beginning of year                              | \$40,626           | 48,505    | 46,402    | 41,402    |
| Provision (reversal) for loan losses   | (780 )             | 10,195    | 30,616    | 79,000    |
|  | 39,846             | 58,700    | 77,018    | 121,402   |
| Loans charged off: (1)   |                    |           |           |           |
| Commercial, financial, and agricultural                                      | (3,039 )           | (5,179 )  | (4,667 )  | (5,000 )  |
| Real estate – construction, land development & other land loans              | (3,616 )           | (6,071 )  | (10,582 ) | (28,000 ) |
| Real estate – mortgage – residential (1-4 family) first mortgages            | (5,145 )           | (4,050 )  | (4,764 )  | (15,000 ) |
| Real estate – mortgage – home equity loans / lines of credit                 | (1,117 )           | (1,607 )  | (3,143 )  | (5,900 )  |
| Real estate – mortgage – commercial and other                                | (3,103 )           | (4,405 )  | (7,027 )  | (20,000 ) |
| Installment loans to individuals   | (2,411 )           | (1,924 )  | (2,253 )  | (1,900 )  |
| Total charge-offs  | (18,431 )          | (23,236 ) | (32,436 ) | (77,000 ) |
| Recoveries of loans previously charged-off:                                  |                    |           |           |           |
| Commercial, financial, and agricultural                                      | 934                | 149       | 198       | 152       |
| Real estate – construction, land development & other land loans              | 3,599              | 3,363     | 777       | 1,200     |
| Real estate – mortgage – residential (1-4 family) first mortgages            | 678                | 646       | 595       | 91        |
| Real estate – mortgage – home equity loans / lines of credit                 | 143                | 100       | 199       | 440       |
| Real estate – mortgage – commercial and other                                | 1,390              | 446       | 1,531     | 318       |
| Installment loans to individuals   | 424                | 458       | 623       | 303       |
| Total recoveries   | 7,168              | 5,162     | 3,923     | 2,500     |
| Net charge-offs  | (11,263 )          | (18,074 ) | (28,513 ) | (74,000 ) |
| Allowance for loan losses, at end of year                                    | \$28,583           | 40,626    | 48,505    | 46,402    |
| Ratios:  |                    |           |           |           |
| Net charge-offs as a percent of average loans                                | 0.46%              | 0.74%     | 1.18%     | 3.00%     |
| Allowance for loan losses as a percent of loans at end of year               | 1.13%              | 1.70%     | 1.97%     | 1.99%     |
| Allowance for loan losses as a multiple of net charge-offs                   | 2.54               | x 2.25    | x 1.70    | x 0.62    |
| Provision (reversal) for loan losses as a percent of net charge-offs         | -6.93%             | 56.41%    | 107.38%   | 106.00%   |
| Recoveries of loans previously charged-off as a percent of loans charged-off | 38.89%             | 22.22%    | 12.09%    | 3.30%     |

In the table above, for the period ended December 31, 2012, loan charge-offs include \$37.8 million in charge-offs related to loans that the Company held for sale as of year-end (and subsequently sold in January 2013). The remaining balance of \$30.4 million after the charge-offs were recorded was classified as “Loans held for sale” on the Company’s consolidated balance sheet at December 31, 2012.



Table of Contents**Table 14a - Loan Loss and Recovery Experience – Covered versus Non-covered**

| (\$ in thousands)   | As of December 31, 2015 |             |           | As of<br>Covered |
|---|-------------------------|-------------|-----------|------------------|
|   | Covered                 | Non-covered | Total     |                  |
| Loans outstanding at end of year  | \$102,641               | 2,416,285   | 2,518,926 | 12               |
| Average amount of loans outstanding   | \$114,099               | 2,320,503   | 2,434,602 | 15               |
| Allowance for loan losses, at beginning of year                                   | \$2,281                 | 38,345      | 40,626    | 4,2              |
| Provision (reversal) for loan losses  | (2,788 )                | 2,008       | (780 )    | 3,1              |
| Transfer of covered allowance for loan losses to non-covered status               | —                       | —           | —         | (1,              |
|   | (507 )                  | 40,353      | 39,846    | 5,6              |
| Loans charged off:  |                         |             |           |                  |
| Commercial, financial, and agricultural   | (130 )                  | (2,909 )    | (3,039 )  | (1,              |
| Real estate – construction, land development & other land loans                   | (559 )                  | (3,057 )    | (3,616 )  | (3,              |
| Real estate – mortgage – residential (1-4 family) first mortgages                 | (264 )                  | (4,881 )    | (5,145 )  | (8,              |
| Real estate – mortgage – home equity loans / lines of credit                      | (63 )                   | (1,054 )    | (1,117 )  | (7,              |
| Real estate – mortgage – commercial and other                                     | (300 )                  | (2,803 )    | (3,103 )  | (9,              |
| Installment loans to individuals  | —                       | (2,411 )    | (2,411 )  | (2,              |
| Total charge-offs   | (1,316 )                | (17,115 )   | (18,431 ) | (6,              |
| Recoveries of loans previously charged-off:                                       |                         |             |           |                  |
| Commercial, financial, and agricultural   | 103                     | 831         | 934       | 15               |
| Real estate – construction, land development & other land loans                   | 2,601                   | 998         | 3,599     | 2,9              |
| Real estate – mortgage – residential (1-4 family) first mortgages                 | 399                     | 279         | 678       | 41               |
| Real estate – mortgage – home equity loans / lines of credit                      | 22                      | 121         | 143       | 2                |
| Real estate – mortgage – commercial and other                                     | 485                     | 905         | 1,390     | 24               |
| Installment loans to individuals  | 12                      | 412         | 424       | 1                |
| Total recoveries  | 3,622                   | 3,546       | 7,168     | 3,6              |
| Net (charge-offs) recoveries  | 2,306                   | (13,569 )   | (11,263 ) | (3,              |
| Allowance for loan losses, at end of year   | \$1,799                 | 26,784      | 28,583    | 2,2              |
| Ratios:   |                         |             |           |                  |
| Net charge-offs (recoveries) as a percent of average loans                        | -2.02%                  | 0.58%       | 0.46%     | 2.0              |
| Allowance for loan losses as a percent of loans at end of year                    | 1.75%                   | 1.11%       | 1.13%     | 1.7              |
| Allowance for loan losses as a multiple of net charge-offs (recoveries)           | -0.78 x                 | 1.97 x      | 2.54 x    | 0.6              |
| Provision (reversal) for loan losses as a percent of net charge-offs (recoveries) | 120.90%                 | 14.80%      | -6.93%    | 93               |
| Recoveries of loans previously charged-off as a percent of loans charged-off      | 275.23%                 | 20.72%      | 38.89%    | 52               |

Table of Contents**Table 15 Average Deposits**

| (\$ in thousands)                     | Year Ended December 31,   |                         |                           |                         |                           |                         |
|---------------------------------------|---------------------------|-------------------------|---------------------------|-------------------------|---------------------------|-------------------------|
|                                       | 2015<br>Average<br>Amount | 2015<br>Average<br>Rate | 2014<br>Average<br>Amount | 2014<br>Average<br>Rate | 2013<br>Average<br>Amount | 2013<br>Average<br>Rate |
| Interest-bearing checking accounts    | \$568,329                 | 0.06%                   | \$535,738                 | 0.06%                   | \$530,566                 | 0.09%                   |
| Money market accounts                 | 582,407                   | 0.13%                   | 552,940                   | 0.11%                   | 560,809                   | 0.16%                   |
| Savings accounts                      | 184,821                   | 0.05%                   | 176,362                   | 0.05%                   | 166,388                   | 0.07%                   |
| Time deposits >\$100,000              | 410,692                   | 0.70%                   | 542,303                   | 0.81%                   | 607,028                   | 0.96%                   |
| Other time deposits                   | 322,205                   | 0.39%                   | 387,607                   | 0.43%                   | 469,562                   | 0.56%                   |
| Total interest-bearing deposits       | 2,068,454                 | 0.26%                   | 2,194,950                 | 0.32%                   | 2,334,353                 | 0.43%                   |
| Noninterest-bearing checking accounts | 618,927                   | —                       | 528,808                   | —                       | 444,679                   | —                       |
| Total deposits                        | \$2,687,381               | 0.20%                   | \$2,723,758               | 0.26%                   | \$2,779,032               | 0.36%                   |

**Table 16 Maturities of Time Deposits of \$100,000 or More**

| (\$ in thousands)                  | As of December 31, 2015 |                          |                           |                   |  | Total   |
|------------------------------------|-------------------------|--------------------------|---------------------------|-------------------|--|---------|
|                                    | 3 Months<br>or Less     | Over 3<br>to 6<br>Months | Over 6<br>to 12<br>Months | Over 12<br>Months |  |         |
| Time deposits of \$100,000 or more | \$108,375               | 79,089                   | 139,581                   | 76,500            |  | 403,545 |

Table of Contents**Table 17 Interest Rate Sensitivity Analysis**

| (\$ in thousands)   | Repricing schedule for interest-earning assets and interest-bearing liabilities held as of December 31, 2015 |                     |                        |                |           |
|---|--|---------------------|------------------------|----------------|-----------|
|   | 3 Months or Less   | Over 3 to 12 Months | Total Within 12 Months | Over 12 Months | Total     |
| <b>Earning assets:</b>  |  |                     |                        |                |           |
| Loans (1)   | \$ 748,383   | 171,485             | 919,868                | 1,599,058      | 2,518,926 |
| Securities available for sale (2)   | 29,447   | 15,326              | 44,773                 | 120,841        | 165,614   |
| Securities held to maturity (2)   | 7,996  | 19,002              | 26,998                 | 127,612        | 154,610   |
| Short-term investments  | 218,306  | —                   | 218,036                | —              | 218,036   |
| Total earning assets  | \$ 1,004,132   | 205,813             | 1,209,945              | 1,847,511      | 3,057,456 |
| Percent of total earning assets   | 32.84%   | 6.73%               | 39.57%                 | 60.43%         | 100.00%   |
| Cumulative percent of total earning assets                                      | 32.84%   | 39.57%              | 39.57%                 | 100.00%        | 100.00%   |
| <b>Interest-bearing liabilities:</b>  |  |                     |                        |                |           |
| Interest-bearing checking accounts  | \$ 626,878   | —                   | 626,878                | —              | 626,878   |
| Money market accounts   | 639,189  | —                   | 639,189                | —              | 639,189   |
| Savings accounts  | 186,616  | —                   | 186,616                | —              | 186,616   |
| Time deposits of \$100,000 or more  | 108,375  | 218,670             | 327,045                | 76,500         | 403,545   |
| Other time deposits   | 95,432   | 149,687             | 245,119                | 50,900         | 296,019   |
| Borrowings  | 126,394  | 20,000              | 146,394                | 40,000         | 186,394   |
| Total interest-bearing liabilities  | \$ 1,782,884   | 388,357             | 2,171,241              | 167,400        | 2,338,641 |
| Percent of total interest-bearing liabilities                                   | 76.24%   | 16.61%              | 92.84%                 | 7.16%          | 100.00%   |
| Cumulative percent of total interest-bearing liabilities                        | 76.24%   | 92.84%              | 92.84%                 | 100.00%        | 100.00%   |
| Interest sensitivity gap  | \$(778,752 )   | (182,544 )          | (961,296 )             | 1,680,111      | 718,815   |
| Cumulative interest sensitivity gap   | (778,752 )   | (961,296 )          | (961,296 )             | 718,815        | 718,815   |
| Cumulative interest sensitivity gap as a percent of total earning assets        | (25.47% )  | (31.44% )           | (31.44% )              | 23.51%         | 23.51%    |
| Cumulative ratio of interest-sensitive assets to interest-sensitive liabilities | 56.32%   | 55.73%              | 55.73%                 | 130.74%        | 130.74%   |

The three months or less category for loans includes \$442,860 in adjustable rate loans that have reached their (1) contractual rate floors. Thus, the interest rates on these loans will not decrease any further. For the majority of these loans, it will take an increase in prime rate of at least 200 basis points before the loans will reprice higher. (2) Securities available for sale include government-sponsored enterprise securities, mortgage-backed securities, corporate bonds, and equity securities. Securities held to maturity include mortgage-backed securities and state and local government securities. For fixed rate mortgage-backed securities, the principal is assumed to reprice equally over the average life of the underlying security. All other fixed rate securities are assumed to reprice based

on maturity date or call date. Variable rate securities are included in the period in which they are subject to reprice.

Table of Contents**Table 18 Contractual Obligations and Other Commercial Commitments**

| Contractual Obligations<br>As of December 31, 2015     | Payments Due by Period (\$ in thousands) |  |           |              |                  |
|--|--|--|-----------|--------------|------------------|
|  | Total                                    | On Demand<br>or<br>Less<br>than 1 Year | 1-3 Years | 4-5<br>Years | After 5<br>Years |
| Borrowings   | \$ 186,394                               | 100,000                                | 40,000    | —            | 46,394           |
| Operating leases                                       | 4,667                                    | 1,122                                  | 1,846     | 1,022        | 677              |
| Total contractual cash obligations, excluding deposits | 191,061                                  | 101,122                                | 41,846    | 1,022        | 47,071           |
| Deposits   | 2,811,285                                | 2,681,283                              | 90,747    | 34,920       | 4,335            |
| Total contractual cash obligations, including deposits | \$ 3,002,346                             | 2,782,405                              | 132,593   | 35,942       | 51,406           |

| Other Commercial Commitments<br>As of December 31, 2015 | Amount of Commitment Expiration Per Period (\$ in thousands) |                     |           |           |                  |
|---|--|---------------------|-----------|-----------|------------------|
|   | Total<br>Amounts<br>Committed                                | Less<br>than 1 Year | 1-3 Years | 4-5 Years | After 5<br>Years |
| Credit cards  | \$ 64,039  | 32,020              | 32,019    | —         | —                |
| Lines of credit and loan commitments                    | 460,308  | 187,044             | 43,690    | 46,011    | 183,563          |
| Standby letters of credit                               | 13,057   | 12,988              | 38        | 31        | —                |
| Total commercial commitments                            | \$ 537,404   | 232,052             | 75,747    | 46,042    | 183,563          |

Table of Contents**Table 19 Market Risk Sensitive Instruments**Expected Maturities of Market Sensitive Instruments Held  
at December 31, 2015 Occurring in Indicated Year

|  | 2016        | 2017    | 2018    | 2019    | 2020    | Beyond    | Total     |
|--|-------------|---------|---------|---------|---------|-----------|-----------|
| <i>(\$ in thousands)</i>                       |             |         |         |         |         |           |           |
| Due from banks,<br>interest-bearing            | \$213,426   | —       | —       | —       | —       | —         | 213,426   |
| Federal fund sold                              | 557         | —       | —       | —       | —       | —         | 557       |
| Presold mortgages in process of settlement     | 4,323       | —       | —       | —       | —       | —         | 4,323     |
| Debt Securities - at<br>amortized cost (1) (2) | 55,163      | 52,457  | 53,828  | 68,930  | 58,648  | 32,274    | 321,300   |
| Loans – fixed (3) (4)                          | 171,636     | 145,922 | 251,086 | 227,209 | 211,978 | 638,631   | 1,646,462 |
| Loans – adjustable (3) (4)                     | 179,186     | 69,185  | 64,701  | 66,743  | 48,541  | 396,298   | 824,654   |
| Total  | \$624,291   | 267,564 | 369,615 | 362,882 | 319,167 | 1,067,203 | 3,010,722 |
| Interest-bearing checking accounts             | \$626,878   | —       | —       | —       | —       | —         | 626,878   |
| Money market accounts                          | 639,189     | —       | —       | —       | —       | —         | 639,189   |
| Savings accounts                               | 186,616     | —       | —       | —       | —       | —         | 186,616   |
| Time deposits                                  | 569,562     | 65,143  | 25,604  | 10,840  | 24,080  | 4,335     | 699,564   |
| Borrowings – fixed                             | 100,000     | 20,000  | 20,000  | —       | —       | —         | 140,000   |
| Borrowings – adjustable                        | —           | —       | —       | —       | —       | 46,394    | 46,394    |
| Total  | \$2,122,245 | 85,143  | 45,604  | 10,840  | 24,080  | 50,729    | 2,338,641 |

(1) Tax-exempt securities are reflected at a tax-equivalent basis using a 39% tax rate.

Securities with call dates within 12 months of December 31, 2015 that have above market interest rates are (2) assumed to mature at their call date for purposes of this table. Mortgage securities are assumed to mature in the period of their expected repayment based on estimated prepayment speeds.

(3) Excludes nonaccrual loans.

(4) Loans are shown in the period of their contractual maturity.

**Table 20 Return on Assets and Common Equity**

|                                       | For the Year Ended December 31, |        |        |
|---------------------------------------|---------------------------------|--------|--------|
|                                       | 2015                            | 2014   | 2013   |
| Return on average assets              | 0.82%                           | 0.75%  | 0.62%  |
| Return on average common equity       | 8.04%                           | 7.73%  | 6.78%  |
| Dividend payout ratio – common shares | 23.88%                          | 26.23% | 31.68% |

Average shareholders' equity to average assets 11.65% 11.90% 11.31%

Table of Contents**Table 21 Risk-Based and Leverage Capital Ratios**

| (\$ in thousands)   | As of December 31,           |                         |                         |
|---|------------------------------|-------------------------|-------------------------|
|   | 2015<br>(under<br>Basel III) | 2014<br>(pre-Basel III) | 2013<br>(pre-Basel III) |
| <b>Risk-Based and Leverage Capital</b>                            |                              |                         |                         |
| <b>Common Equity Tier I capital:</b>                              |                              |                         |                         |
| Shareholders' equity  | \$342,190                    | 387,699                 | 371,922                 |
| Preferred stock   | (7,287 )                     | (70,787 )               | (70,787 )               |
| Intangible assets, net of deferred tax liability                  | (55,687 )                    | (67,893 )               | (68,669 )               |
| Accumulated other comprehensive income adjustments                | 3,550                        | 578                     | (1,900 )                |
| Total Common Equity Tier I capital                                | 282,766                      | 249,597                 | 230,566                 |
| <b>Tier I capital:</b>  |                              |                         |                         |
| Preferred stock   | 7,287                        | 70,787                  | 70,787                  |
| Trust preferred securities eligible for Tier I capital treatment  | 45,000                       | 45,000                  | 45,000                  |
| Total Tier I leverage capital                                     | 335,053                      | 365,384                 | 346,353                 |
| <b>Tier II capital:</b>   |                              |                         |                         |
| Allowable allowance for loan losses                               | 28,583                       | 28,096                  | 28,127                  |
| Other Tier II capital   | 489                          | —                       | —                       |
| Tier II capital additions   | 29,072                       | 28,096                  | 28,127                  |
| Total capital   | \$364,125                    | 393,480                 | 374,480                 |
| Total risk weighted assets  | \$2,519,193                  | 2,235,143               | 2,229,776               |
| Adjusted fourth quarter average assets                            | 3,227,166                    | 3,146,409               | 3,099,007               |
| <b>Risk-based capital ratios:</b>                                 |                              |                         |                         |
| Common equity Tier I capital to Tier I risk adjusted assets       | 11.22%                       | 11.17%                  | 10.34%                  |
| Minimum required Common equity Tier I capital                     | 4.50%                        | n/a                     | n/a                     |
| Tier I capital to Tier I risk adjusted assets                     | 13.30%                       | 16.35%                  | 15.53%                  |
| Minimum required Tier I capital                                   | 6.00%                        | 4.00%                   | 4.00%                   |
| Total risk-based capital to Tier II risk-adjusted assets          | 14.45%                       | 17.60%                  | 16.79%                  |
| Minimum required total risk-based capital                         | 8.00%                        | 8.00%                   | 8.00%                   |
| <b>Leverage capital ratios:</b>                                   |                              |                         |                         |
| Tier I leverage capital to adjusted fourth quarter average assets | 10.38%                       | 11.61%                  | 11.18%                  |
| Minimum required Tier I leverage capital                          | 4.00%                        | 4.00%                   | 4.00%                   |

n/a – not applicable. Common Equity Tier I capital and related ratios were not required until Basel III became effective on January 1, 2015.





Table of Contents**Table 22 Quarterly Financial Summary (Unaudited)**

|  | 2015              |                  |                   |                  | 2014              |
|--|-------------------|------------------|-------------------|------------------|-------------------|
| <i>(\$ in thousands except<br/>per share data)</i>         | Fourth<br>Quarter | Third<br>Quarter | Second<br>Quarter | First<br>Quarter | Fourth<br>Quarter |
| <b>Income Statement Data</b>                               |                   |                  |                   |                  |                   |
| Interest income, taxable equivalent                        | \$32,230          | 32,549           | 31,662            | 31,848           | 33,203            |
| Interest expense   | 1,754             | 1,744            | 1,655             | 1,755            | 1,904             |
| Net interest income, taxable equivalent                    | 30,476            | 30,805           | 30,007            | 30,093           | 31,299            |
| Taxable equivalent, adjustment                             | 423               | 419              | 402               | 390              | 376               |
| Net interest income  | 30,053            | 30,386           | 29,605            | 29,703           | 30,923            |
| Provision (reversal) for loan losses                       | (43 )             | (1,414 )         | 841               | (164 )           | 1,476             |
| Net interest income after provision for losses             | 30,096            | 31,800           | 28,764            | 29,867           | 29,447            |
| Noninterest income   | 5,725             | 3,506            | 5,004             | 4,529            | 4,492             |
| Noninterest expense  | 25,503            | 24,614           | 24,300            | 23,714           | 22,989            |
| Income before income taxes                                 | 10,318            | 10,692           | 9,468             | 10,682           | 10,950            |
| Income taxes   | 3,521             | 3,687            | 3,224             | 3,694            | 3,855             |
| Net income   | 6,797             | 7,005            | 6,244             | 6,988            | 7,095             |
| Preferred stock dividends                                  | (37 )             | (137 )           | (212 )            | (217 )           | (217 )            |
| Net income available to common shareholders                | 6,760             | 6,868            | 6,032             | 6,771            | 6,878             |
| <b>Per Common Share Data</b>                               |                   |                  |                   |                  |                   |
| Earnings per common share – basic                          | \$0.34            | 0.35             | 0.30              | 0.34             | 0.35              |
| Earnings per common share – diluted                        | 0.33              | 0.34             | 0.30              | 0.33             | 0.34              |
| Cash dividends declared                                    | 0.08              | 0.08             | 0.08              | 0.08             | 0.08              |
| <b>Market Price</b>  |                   |                  |                   |                  |                   |
| High   | 19.92             | 17.86            | 17.85             | 18.64            | 18.86             |
| Low  | 16.01             | 16.01            | 15.18             | 15.00            | 15.55             |
| Close  | 18.74             | 17.00            | 16.68             | 17.56            | 18.47             |
| Stated book value - common                                 | 16.96             | 16.80            | 16.51             | 16.34            | 16.08             |
| Tangible book value - common                               | 13.56             | 13.40            | 13.10             | 12.90            | 12.63             |
| <b>Selected Average Balances</b>                           |                   |                  |                   |                  |                   |
| Assets   | \$3,282,853       | 3,244,515        | 3,199,270         | 3,194,570        | 3,214,111         |
| Loans  | 2,504,022         | 2,453,580        | 2,389,735         | 2,391,071        | 2,411,111         |
| Earning assets   | 2,982,356         | 2,951,638        | 2,901,770         | 2,910,732        | 2,920,111         |
| Deposits   | 2,732,231         | 2,680,671        | 2,667,649         | 2,688,973        | 2,691,111         |
| Interest-bearing liabilities                               | 2,258,911         | 2,223,025        | 2,180,746         | 2,210,302        | 2,235,111         |
| Shareholders' equity                                       | 348,777           | 369,499          | 394,699           | 392,173          | 389,700           |
| <b>Ratios (annualized where applicable)</b>                |                   |                  |                   |                  |                   |
| Return on average assets                                   | 0.82%             | 0.84%            | 0.76%             | 0.86%            | 0.85%             |
| Return on average common equity                            | 7.96%             | 8.23%            | 7.42%             | 8.54%            | 8.56%             |
| Equity to assets at end of period                          | 10.18%            | 11.34%           | 11.38%            | 12.21%           | 12.05%            |
| Tangible equity to tangible assets at end of period        | 8.35%             | 9.48%            | 9.47%             | 10.33%           | 10.15%            |
| Tangible common equity to tangible assets at end of period | 8.13%             | 8.27%            | 8.24%             | 8.08%            | 7.90%             |
| Average loans to average deposits                          | 91.65%            | 91.53%           | 89.58%            | 88.92%           | 89.60%            |
| Average earning assets to interest- bearing liabilities    | 132.03%           | 132.78%          | 133.06%           | 131.69%          | 130.62%           |

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|   |       |       |       |       |       |
|---|-------|-------|-------|-------|-------|
| Net interest margin   | 4.05% | 4.14% | 4.15% | 4.19% | 4.25% |
| Allowance for loan losses to gross loans                          | 1.13% | 1.21% | 1.33% | 1.50% | 1.70% |
| Nonperforming loans as a percent of total loans                   | 3.15% | 3.26% | 3.63% | 3.92% | 4.25% |
| Nonperforming loans as a percent of total loans – non-covered     | 2.81% | 3.01% | 3.31% | 3.58% | 3.77% |
| Nonperforming assets as a percent of total assets                 | 2.66% | 2.80% | 3.09% | 3.26% | 3.54% |
| Nonperforming assets as a percent of total assets – non-covered   | 2.37% | 2.56% | 2.78% | 2.92% | 3.09% |
| Net charge-offs as a percent of average total loans               | 0.23% | 0.10% | 0.80% | 0.76% | 0.82% |
| Net charge-offs as a percent of average total loans – non-covered | 0.33% | 0.38% | 0.81% | 0.84% | 0.78% |

Table of Contents**Item 8. Financial Statements and Supplementary Data**

First Bancorp and Subsidiaries

**Consolidated Balance Sheets****December 31, 2015 and 2014**

| (\$ in thousands)  | 2015        | 2014      |
|--|-------------|-----------|
| <b>Assets</b>  |             |           |
| Cash and due from banks, noninterest-bearing   | \$53,285    | 81,068    |
| Due from banks, interest-bearing   | 213,426     | 171,248   |
| Federal funds sold   | 557         | 768       |
| Total cash and cash equivalents  | 267,268     | 253,084   |
| Securities available for sale  | 165,614     | 158,018   |
| Securities held to maturity (fair values of \$157,146 in 2015 and \$182,411 in 2014) | 154,610     | 178,687   |
| Presold mortgages in process of settlement   | 4,323       | 6,019     |
| Loans – non-covered  | 2,416,285   | 2,268,580 |
| Loans – covered by FDIC loss share agreement   | 102,641     | 127,594   |
| Total loans  | 2,518,926   | 2,396,174 |
| Allowance for loan losses – non-covered  | (26,784 )   | (38,345 ) |
| Allowance for loan losses – covered  | (1,799 )    | (2,281 )  |
| Total allowance for loan losses  | (28,583 )   | (40,626 ) |
| Net loans  | 2,490,343   | 2,355,548 |
| Premises and equipment   | 74,559      | 75,113    |
| Accrued interest receivable  | 9,166       | 8,920     |
| FDIC indemnification asset   | 8,439       | 22,569    |
| Goodwill   | 65,835      | 65,835    |
| Other intangible assets  | 1,336       | 2,058     |
| Foreclosed real estate – non-covered   | 9,188       | 9,771     |
| Foreclosed real estate – covered   | 806         | 2,350     |
| Bank-owned life insurance  | 72,086      | 55,421    |
| Other assets   | 38,492      | 24,990    |
| Total assets   | \$3,362,065 | 3,218,383 |
| <b>Liabilities</b>   |             |           |
| Deposits: Noninterest-bearing checking accounts                                      | \$659,038   | 560,230   |
| Interest-bearing checking accounts   | 626,878     | 583,903   |
| Money market accounts  | 639,189     | 551,002   |

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|                                    |           |           |
|------------------------------------|-----------|-----------|
| Savings accounts                   | 186,616   | 180,317   |
| Time deposits of \$100,000 or more | 403,545   | 470,066   |
| Other time deposits                | 296,019   | 350,388   |
| Total deposits                     | 2,811,285 | 2,695,906 |
| Borrowings                         | 186,394   | 116,394   |
| Accrued interest payable           | 585       | 686       |
| Other liabilities                  | 21,611    | 17,698    |
| Total liabilities                  | 3,019,875 | 2,830,684 |

Commitments and contingencies (see Note 13)

Shareholders' Equity

|   |             |           |
|---|-------------|-----------|
| Preferred stock, no par value per share. Authorized: 5,000,000 shares         |             |           |
| Series B issued & outstanding: None in 2015 and 63,500 in 2014                | —           | 63,500    |
| Series C, convertible, issued & outstanding: 728,706 in 2015 and 2014         | 7,287       | 7,287     |
| Common stock, no par value per share. Authorized: 40,000,000 shares           |             |           |
| Issued & outstanding: 19,747,509 shares in 2015 and 19,709,881 shares in 2014 | 133,393     | 132,532   |
| Retained earnings   | 205,060     | 184,958   |
| Accumulated other comprehensive income (loss)                                 | (3,550 )    | (578 )    |
| Total shareholders' equity  | 342,190     | 387,699   |
| Total liabilities and shareholders' equity                                    | \$3,362,065 | 3,218,383 |

*See accompanying notes to consolidated financial statements.*

Table of Contents**First Bancorp and Subsidiaries****Consolidated Statements of Income****Years Ended December 31, 2015, 2014 and 2013**

| (\$ in thousands, except per share data)                   | 2015           | 2014            | 2013           |
|--|----------------|-----------------|----------------|
| <b>Interest Income</b>                                     |                |                 |                |
| Interest and fees on loans                                 | \$ 117,872     | 133,641         | 141,616        |
| Interest on investment securities:                         |                |                 |                |
| Taxable interest income                                    | 6,296          | 3,461           | 3,410          |
| Tax-exempt interest income                                 | 1,829          | 1,881           | 1,899          |
| Other, principally overnight investments                   | 658            | 849             | 586            |
| <b>Total interest income</b>                               | <b>126,655</b> | <b>139,832</b>  | <b>147,511</b> |
| <b>Interest Expense</b>                                    |                |                 |                |
| Savings, checking and money market accounts                | 1,192          | 1,040           | 1,493          |
| Time deposits of \$100,000 or more                         | 2,856          | 4,373           | 5,825          |
| Other time deposits  | 1,271          | 1,659           | 2,642          |
| Borrowings   | 1,589          | 1,151           | 1,025          |
| <b>Total interest expense</b>                              | <b>6,908</b>   | <b>8,223</b>    | <b>10,985</b>  |
| <b>Net interest income</b>                                 | <b>119,747</b> | <b>131,609</b>  | <b>136,526</b> |
| Provision for loan losses – non-covered                    | 2,008          | 7,087           | 18,266         |
| Provision (reversal) for loan losses – covered             | (2,788)        | ) 3,108         | 12,350         |
| <b>Total provision (reversal) for loan losses</b>          | <b>(780)</b>   | <b>) 10,195</b> | <b>30,616</b>  |
| <b>Net interest income after provision for loan losses</b> | <b>120,527</b> | <b>121,414</b>  | <b>105,910</b> |
| <b>Noninterest Income</b>                                  |                |                 |                |
| Service charges on deposit accounts                        | 11,648         | 13,706          | 12,752         |
| Other service charges, commissions and fees                | 10,906         | 10,019          | 9,318          |
| Fees from presold mortgage loans                           | 2,532          | 2,726           | 2,907          |
| Commissions from sales of insurance and financial products | 2,580          | 2,733           | 2,132          |
| Bank-owned life insurance income                           | 1,665          | 1,311           | 1,120          |
| Foreclosed property gains (losses) – non-covered           | (2,504)        | ) (1,924)       | ) 1,333        |
| Foreclosed property gains (losses) – covered               | 1,018          | (1,919)         | ) 367          |
| FDIC indemnification asset income (expense), net           | (8,615)        | ) (12,842)      | ) (6,824)      |
| Securities gains (losses), net                             | (1)            | ) 786           | 532            |
| Other gains (losses), net                                  | (465)          | ) (228)         | ) (148)        |
| <b>Total noninterest income</b>                            | <b>18,764</b>  | <b>14,368</b>   | <b>23,489</b>  |
| <b>Noninterest Expenses</b>                                |                |                 |                |
| Salaries   | 47,660         | 46,071          | 45,120         |
| Employee benefits  | 9,134          | 9,086           | 9,644          |
| <b>Total personnel expense</b>                             | <b>56,794</b>  | <b>55,157</b>   | <b>54,764</b>  |
| Occupancy expense  | 7,358          | 7,362           | 7,123          |
| Equipment related expenses                                 | 3,749          | 3,931           | 4,364          |

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|   |            |            |            |
|---|------------|------------|------------|
| Intangibles amortization                    | 722        | 777        | 860        |
| Other operating expenses                    | 29,508     | 30,024     | 29,508     |
| Total noninterest expenses                  | 98,131     | 97,251     | 96,619     |
| Income before income taxes                  | 41,160     | 38,531     | 32,780     |
| Income tax expense                          | 14,126     | 13,535     | 12,081     |
| Net income                                  | 27,034     | 24,996     | 20,699     |
| Preferred stock dividends                   | (603 )     | (868 )     | (895 )     |
| Net income available to common shareholders | \$26,431   | 24,128     | 19,804     |
| Earnings per common share: Basic            | \$1.34     | 1.22       | 1.01       |
| Earnings per common share: Diluted          | 1.30       | 1.19       | 0.98       |
| Dividends declared per common share         | \$0.32     | 0.32       | 0.32       |
| Weighted average common shares outstanding: |            |            |            |
| Basic                                       | 19,767,470 | 19,699,801 | 19,675,597 |
| Diluted                                     | 20,499,727 | 20,434,007 | 20,404,303 |

*See accompanying notes to consolidated financial statements.*

Table of Contents**First Bancorp and Subsidiaries****Consolidated Statements of Comprehensive Income****Years Ended December 31, 2015, 2014 and 2013**

| (\$ in thousands)   | 2015     | 2014     | 2013     |
|---|----------|----------|----------|
| Net income  | \$27,034 | 24,996   | 20,699   |
| Other comprehensive income (loss):                                  |          |          |          |
| Unrealized gains (losses) on securities available for sale:         |          |          |          |
| Unrealized holding gains (losses) arising during the period, pretax | (473 )   | 2,115    | (4,779 ) |
| Tax (expense) benefit   | 184      | (825 )   | 1,865    |
| Reclassification to realized (gains) losses                         | 1        | (786 )   | (532 )   |
| Tax expense (benefit)   | —        | 307      | 207      |
| Postretirement plans:   |          |          |          |
| Net gain (loss) arising during period                               | (4,321 ) | (5,171 ) | 8,765    |
| Tax (expense) benefit   | 1,685    | 2,017    | (3,419 ) |
| Amortization of unrecognized net actuarial (gain) loss              | (79 )    | (221 )   | (51 )    |
| Tax expense (benefit)   | 31       | 86       | 20       |
| Other comprehensive income (loss)                                   | (2,972 ) | (2,478 ) | 2,076    |
| Comprehensive income  | \$24,062 | 22,518   | 22,775   |

*See accompanying notes to consolidated financial statements.*



Table of Contents**First Bancorp and Subsidiaries****Consolidated Statements of Shareholders' Equity****Years Ended December 31, 2015, 2014 and 2013**

| (In thousands)                             | Preferred<br>Stock | Common Stock<br>Shares | Common Stock<br>Amount | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Total<br>Share-<br>holders'<br>Equity |
|--|--------------------|------------------------|------------------------|----------------------|--|---------------------------------------|
| Balances, January 1, 2013                  | \$70,787           | 19,669                 | \$131,877              | 153,629              | (176 )   | 356,117                               |
| Net income                                 |                    |                        |                        | 20,699               |  | 20,699                                |
| Cash dividends declared (\$0.32 per share) |                    |                        |                        | (6,297 )             |  | (6,297 )                              |
| Preferred dividends                        |                    |                        |                        | (895 )               |  | (895 )                                |
| Stock-based compensation                   |                    | 11                     | 222                    |                      |  | 222                                   |
| Other comprehensive income                 |                    |                        |                        |                      | 2,076  | 2,076                                 |
| Balances, December 31, 2013                | 70,787             | 19,680                 | 132,099                | 167,136              | 1,900  | 371,922                               |
| Net income                                 |                    |                        |                        | 24,996               |  | 24,996                                |
| Stock option exercises                     |                    | 5                      | 70                     |                      |  | 70                                    |
| Cash dividends declared (\$0.32 per share) |                    |                        |                        | (6,306 )             |  | (6,306 )                              |
| Preferred dividends                        |                    |                        |                        | (868 )               |  | (868 )                                |
| Stock-based compensation                   |                    | 25                     | 363                    |                      |  | 363                                   |
| Other comprehensive income (loss)          |                    |                        |                        |                      | (2,478 )   | (2,478 )                              |
| Balances, December 31, 2014                | 70,787             | 19,710                 | 132,532                | 184,958              | (578 )   | 387,699                               |
| Net income                                 |                    |                        |                        | 27,034               |  | 27,034                                |
| Preferred stock redeemed (Series B)        | (63,500)           |                        |                        |                      |  | (63,500 )                             |
| Stock option exercises                     |                    | 7                      | 112                    |                      |  | 112                                   |
| Stock withheld for payment of taxes        |                    | (3 )                   | (54 )                  |                      |  | (54 )                                 |
| Cash dividends declared (\$0.32 per share) |                    |                        |                        | (6,329 )             |  | (6,329 )                              |
| Preferred dividends                        |                    |                        |                        | (603 )               |  | (603 )                                |
| Stock-based compensation                   |                    | 34                     | 803                    |                      |  | 803                                   |
| Other comprehensive income (loss)          |                    |                        |                        |                      | (2,972 )   | (2,972 )                              |
| Balances, December 31, 2015                | \$7,287            | 19,748                 | \$133,393              | 205,060              | (3,550 )   | 342,190                               |

*See accompanying notes to consolidated financial statements.*

Table of Contents**First Bancorp and Subsidiaries****Consolidated Statements of Cash Flows****Years Ended December 31, 2015, 2014 and 2013**

| (\$ in thousands)  | 2015       | 2014       | 2013       |
|--|------------|------------|------------|
| <b>Cash Flows From Operating Activities</b>                                |            |            |            |
| Net income   | \$27,034   | 24,996     | 20,699     |
| Reconciliation of net income to net cash provided by operating activities: |            |            |            |
| Provision (reversal) for loan losses                                       | (780 )     | 10,195     | 30,616     |
| Net security premium amortization  | 3,247      | 1,934      | 2,667      |
| Purchase accounting accretion and amortization, net                        | 2,706      | (7,589 )   | (15,478 )  |
| Foreclosed property (gains) losses and write-downs, net                    | 1,486      | 3,843      | (1,700 )   |
| Loss (gain) on securities available for sale                               | 1          | (786 )     | (532 )     |
| Other losses   | 465        | 228        | 148        |
| Decrease (increase) in net deferred loan costs                             | 73         | (17 )      | 396        |
| Depreciation of premises and equipment                                     | 4,494      | 4,618      | 4,623      |
| Stock-based compensation expense   | 710        | 270        | 222        |
| Amortization of intangible assets  | 722        | 777        | 860        |
| Originations of presold mortgages in process of settlement                 | (97,118 )  | (101,493 ) | (103,877 ) |
| Proceeds from sales of presold mortgages in process of settlement          | 98,783     | 101,047    | 106,787    |
| Decrease (increase) in accrued interest receivable                         | (246 )     | 729        | 552        |
| Decrease (increase) in other assets  | (3,904 )   | 6,586      | 22,199     |
| Decrease in accrued interest payable                                       | (101 )     | (193 )     | (447 )     |
| Increase (decrease) in other liabilities                                   | (222 )     | 2,675      | 4,145      |
| Net cash provided by operating activities                                  | 37,350     | 47,820     | 71,880     |
| <b>Cash Flows From Investing Activities</b>                                |            |            |            |
| Purchases of securities available for sale                                 | (95,822 )  | (66,263 )  | (65,733 )  |
| Purchases of securities held to maturity                                   | (857 )     | (125,377 ) | —          |
| Proceeds from sales of securities available for sale                       | —          | 47,473     | 12,908     |
| Proceeds from maturities/issuer calls of securities available for sale     | 86,238     | 30,332     | 38,881     |
| Proceeds from maturities/issuer calls of securities held to maturity       | 23,203     | 453        | 1,837      |
| Purchases of Federal Reserve and Federal Home Loan Bank stock, net         | (9,877 )   | (2,122 )   | 1,040      |
| Purchase of bank-owned life insurance                                      | (15,000 )  | (10,000 )  | (15,000 )  |
| Net (increase) decrease in loans   | (138,346 ) | 52,157     | (101,444 ) |
| Proceeds from FDIC loss share agreements                                   | 6,673      | 17,724     | 49,572     |
| Proceeds from sales of foreclosed real estate                              | 9,650      | 33,262     | 60,564     |
| Purchases of premises and equipment  | (5,481 )   | (4,751 )   | (6,293 )   |
| Proceeds from sales of premises and equipment                              | 1,621      | 1,309      | —          |
| Proceeds from loans held for sale  | —          | —          | 30,393     |
| Net cash received in acquisition   | —          | —          | 38,315     |
| Net cash provided (used) by investing activities                           | (137,998 ) | (25,803 )  | 45,040     |
| <b>Cash Flows From Financing Activities</b>                                |            |            |            |
| Net increase (decrease) in deposits  | 115,379    | (55,106 )  | (127,646 ) |

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|   |           |          |           |
|---|-----------|----------|-----------|
| Net increase in borrowings  | 70,000    | 70,000   | —         |
| Cash dividends paid – common stock                                    | (6,309 )  | (6,303 ) | (6,297 )  |
| Cash dividends paid – preferred stock                                 | (796 )    | (868 )   | (1,210 )  |
| Redemption of preferred stock   | (63,500 ) | —        | —         |
| Proceeds from stock option exercises                                  | 112       | 70       | —         |
| Stock withheld for payment of taxes                                   | (54 )     | —        | —         |
| Net cash provided (used) by financing activities                      | 114,832   | 7,793    | (135,153) |
| Increase (Decrease) in Cash and Cash Equivalents                      | 14,184    | 29,810   | (18,233 ) |
| Cash and Cash Equivalents, Beginning of Year                          | 253,084   | 223,274  | 241,507   |
| Cash and Cash Equivalents, End of Year                                | \$267,268 | 253,084  | 223,274   |
| Supplemental Disclosures of Cash Flow Information:                    |           |          |           |
| Cash paid during the period for interest                              | \$7,009   | 8,416    | 11,405    |
| Cash paid during the period for income taxes                          | 13,815    | 5,096    | 1,082     |
| Non-cash investing and financing transactions:                        |           |          |           |
| Foreclosed loans transferred to foreclosed real estate                | 9,009     | 12,717   | 22,037    |
| Unrealized gain (loss) on securities available for sale, net of taxes | (288 )    | 811      | (3,240 )  |

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**First Bancorp and Subsidiaries**

**Notes to Consolidated Financial Statements**

**December 31, 2015**

**Note 1. Summary of Significant Accounting Policies**

**(a) Basis of Presentation** - The consolidated financial statements include the accounts of First Bancorp (the Company) and its wholly owned subsidiary - First Bank (the Bank). The Bank has two wholly owned subsidiaries that are fully consolidated - First Bank Insurance Services, Inc. (First Bank Insurance) and First Troy SPE, LLC. All significant intercompany accounts and transactions have been eliminated. Subsequent events have been evaluated through the date of filing this Form 10-K.

The Company is a bank holding company. The principal activity of the Company is the ownership and operation of the Bank, a state chartered bank with its main office in Southern Pines, North Carolina. The Company is also the parent company for a series of statutory trusts that were formed at various times since 2002 for the purpose of issuing trust preferred debt securities. The trusts are not consolidated for financial reporting purposes; however, notes issued by the Company to the trusts in return for the proceeds from the issuance of the trust preferred securities are included in the consolidated financial statements and have terms that are substantially the same as the corresponding trust preferred securities. The trust preferred securities qualify as capital for regulatory capital adequacy requirements. First Bank Insurance is an agent for property and casualty insurance policies. First Troy SPE, LLC was formed in order to hold and dispose of certain real estate foreclosed upon by the Bank.

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The most significant estimates made by the Company in the preparation of its consolidated financial statements are the determination of the allowance for loan losses, the valuation of other real estate, the accounting and impairment testing related to intangible assets, and the fair value and discount accretion of loans acquired in FDIC-assisted transactions.

**(b) Cash and Cash Equivalents** - The Company considers all highly liquid assets such as cash on hand, noninterest-bearing and interest-bearing amounts due from banks and federal funds sold to be “cash equivalents.”

**(c) Securities** - Debt securities that the Company has the positive intent and ability to hold to maturity are classified as “held to maturity” and carried at amortized cost. Securities not classified as held to maturity are classified as “available for sale” and carried at fair value, with unrealized gains and losses being reported as other comprehensive income or loss and reported as a separate component of shareholders’ equity.

A decline in the market value of any available for sale or held to maturity security below cost that is deemed to be other than temporary results in a reduction in carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. Any equity security that is in an unrealized loss position for twelve consecutive months is presumed to be other than temporarily impaired and an impairment charge is recorded unless the amount of the charge is insignificant.

Gains and losses on sales of securities are recognized at the time of sale based upon the specific identification method. Premiums and discounts are amortized into income on a level yield basis, with premiums being amortized to the earliest call date and discounts being accreted to the stated maturity date.

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**(d) Premises and Equipment** - Premises and equipment are stated at cost less accumulated depreciation. Depreciation, computed by the straight-line method, is charged to operations over the estimated useful lives of the properties, which range from 2 to 40 years or, in the case of leasehold improvements, over the term of the lease, if shorter. Maintenance and repairs are charged to operations in the year incurred. Gains and losses on dispositions are included in current operations.

**(e) Loans** – Loans are stated at the principal amount outstanding less any partial charge-offs plus deferred origination costs, net of nonrefundable loan fees. Interest on loans is accrued on the unpaid principal balance outstanding. Net deferred loan origination costs/fees are capitalized and recognized as a yield adjustment over the life of the related loan.

The Company does not hold any interest-only strips, loans, other receivables, or retained interests in securitizations that can be contractually prepaid or otherwise settled in a way that it would not recover substantially all of its recorded investment.

Purchased loans acquired in a business combination, which include loans that were purchased in the 2009 Cooperative Bank acquisition and the 2011 Bank of Asheville acquisition, are recorded at estimated fair value on their purchase date. The purchaser cannot carry over any related allowance for loan losses.

The Company follows specific accounting guidance related to purchased impaired loans when purchased loans have evidence of credit deterioration since origination and it is probable at the date of acquisition that the Company will not collect all contractually required principal and interest payments. Evidence of credit quality deterioration as of the purchase date may include statistics such as past due and nonaccrual status. The accounting guidance permits the use of the cost recovery method of income recognition for those purchased impaired loans for which the timing and amount of cash flows expected to be collected cannot be reasonably estimated. Under the cost recovery method of income recognition, all cash receipts are initially applied to principal, with interest income being recorded only after the carrying value of the loan has been reduced to zero. Substantially all of the Company's purchased impaired loans to date have had uncertain cash flows and thus are accounted for under the cost recovery method of income recognition.

For nonimpaired purchased loans, the Company accretes any fair value discount over the life of the loan in a manner consistent with the guidance for accounting for loan origination fees and costs.

A loan is placed on nonaccrual status when, in management's judgment, the collection of interest appears doubtful. The accrual of interest is discontinued on all loans that become 90 days or more past due with respect to principal or interest. The past due status of loans is based on the contractual payment terms. While a loan is on nonaccrual status, the Company's policy is that all cash receipts are applied to principal. Once the recorded principal balance has been reduced to zero, future cash receipts are applied to recoveries of any amounts previously charged off. Further cash

receipts are recorded as interest income to the extent that any interest has been foregone. Loans are removed from nonaccrual status when they become current as to both principal and interest, when concern no longer exists as to the collectability of principal or interest, and when the loan has provided generally six months of satisfactory payment performance. In some cases, where borrowers are experiencing financial difficulties, loans may be restructured to provide terms significantly different from the originally contracted terms. For a nonaccrual loan that has been restructured, if the borrower has six months of satisfactory performance under the restructured terms and it is reasonably assured that the borrower will continue to be able to comply with the restructured terms, the loan may be returned to accruing status. The nonaccrual policy discussed above applies to all loan classifications.

A loan is considered to be impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. A loan is specifically evaluated for an appropriate valuation allowance if the loan balance is above a prescribed evaluation threshold (which varies based on credit quality, accruing status, troubled debt restructured status, and type of

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collateral) and the loan is determined to be impaired. Impaired loans are measured using either 1) an estimate of the cash flows that the Company expects to receive from the borrower discounted at the loan's effective rate, or 2) in the case of a collateral-dependent loan, the fair value of the collateral. Unless restructured, while a loan is considered to be impaired, the Company's policy is that interest accrual is discontinued and all cash receipts are applied to principal. Once the recorded principal balance has been reduced to zero, future cash receipts are applied to recoveries of any amounts previously charged off. Further cash receipts are recorded as interest income to the extent that any interest has been foregone. Impaired loans that are restructured are returned to accruing status in accordance with the restructured terms if the Company believes that the borrower will be able to meet the obligations of the restructured loan terms, and the loan has provided generally six months of satisfactory payment performance. The impairment policy discussed above applies to all loan classifications.

**(f) Presold Mortgages in Process of Settlement** - As a part of normal business operations, the Company originates residential mortgage loans that have been pre-approved by secondary investors to be sold on a best efforts basis. The terms of the loans are set by the secondary investors, and the purchase price that the investor will pay for the loan is agreed to prior to the funding of the loan by the Company. Generally within three weeks after funding, the loans are transferred to the investor in accordance with the agreed-upon terms. The Company records gains from the sale of these loans on the settlement date of the sale equal to the difference between the proceeds received and the carrying amount of the loan. The gain generally represents the portion of the proceeds attributed to service release premiums received from the investors and the realization of origination fees received from borrowers that were deferred as part of the carrying amount of the loan. Between the initial funding of the loans by the Company and the subsequent reimbursement by the investors, the Company carries the loans on its balance sheet at the lower of cost or market.

Periodically, the Company originates commercial loans and decides to sell them in the secondary market. The Company carries these loans at the lower of cost or fair value at each reporting date. There were no such loans held for sale as of December 31, 2015 or 2014.

**(g) Allowance for Loan Losses** - The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged-off against the allowance for loan losses when management believes that the collectability of the principal is unlikely. Recoveries on loans previously charged-off are added back to the allowance. The provision for loan losses charged to operations is an amount sufficient to bring the allowance for loan losses to an estimated balance considered adequate to absorb losses inherent in the portfolio. Management's determination of the adequacy of the allowance is based on several factors, including:

1. Risk grades assigned to the loans in the portfolio,
2. Specific reserves for individually evaluated impaired loans,
3. Current economic conditions, including the local, state, and national economic outlook; interest rate risk; trends in loan volume, mix and size of loans; levels and trends of delinquencies,
4. Historical loan loss experience, and
5. An assessment of the risk characteristics of the Company's loan portfolio, including industry concentrations, payment structures, and credit administration practices.



While management uses the best information available to make evaluations, future adjustments may be necessary if economic and other conditions differ substantially from the assumptions used.

For loans covered under loss share agreements, subsequent decreases to the expected cash flows will generally result in additional provisions for loan losses. Subsequent increases in expected cash flows will result in a reversal of the allowance for loan losses to the extent of prior allowance recognition.

In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to recognize additions to the allowance based on the examiners' judgment about information available to them at the time of their examinations.

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**(h) Foreclosed Real Estate** - Foreclosed real estate consists primarily of real estate acquired by the Company through legal foreclosure or deed in lieu of foreclosure. The property is initially carried at the lower of cost (generally the loan balance plus additional costs incurred for improvements to the property) or the estimated fair value of the property less estimated selling costs (also see Note 14). If there are subsequent declines in fair value, which is reviewed routinely by management, the property is written down to its fair value through a charge to expense. Capital expenditures made to improve the property are capitalized. Costs of holding real estate, such as property taxes, insurance and maintenance, less related revenues during the holding period, are recorded as expense.

**(i) FDIC Indemnification Asset** – The FDIC indemnification asset relates to loss share agreements with the FDIC, whereby the FDIC has agreed to reimburse to the Company a percentage of the losses related to loans and other real estate that the Company assumed in the acquisition of two failed banks. This indemnification asset is measured separately from the loan portfolio and foreclosed real estate because it is not contractually embedded in the loans and is not transferable with the loans should the Company choose to dispose of them. The carrying value of this receivable at each period end is the sum of: 1) the receivable (payable) related to actual loss claims (recoveries) that have been submitted to the FDIC for reimbursement (repayment) and 2) the receivable associated with the Company’s estimated amount of loan and foreclosed real estate losses covered by the agreements multiplied by the FDIC reimbursement percentage.

**(j) Income Taxes** - Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred tax assets are reduced, if necessary, by the amount of such benefits that are not expected to be realized based upon available evidence. The Company’s investment tax credits, which are low income housing tax credits and state historic tax credits, are recorded in the period that they are reflected in the Company’s tax returns.

**(k) Intangible Assets** - Business combinations are accounted for using the purchase method of accounting. Identifiable intangible assets are recognized separately and are amortized over their estimated useful lives, which for the Company has generally been seven to ten years and at an accelerated rate. Goodwill is recognized in business combinations to the extent that the price paid exceeds the fair value of the net assets acquired, including any identifiable intangible assets. Goodwill is not amortized, but as discussed in Note 1(q), is subject to fair value impairment tests on at least an annual basis.

**(l) Bank-owned life insurance** – The Company has purchased life insurance policies on certain current and past key employees and directors where the insurance policy benefits and ownership are retained by the employer. These policies are recorded at their cash surrender value. Income from these policies and changes in the net cash surrender value are recorded within noninterest income as “Bank-owned life insurance income.”

**(m) Other Investments** – The Company accounts for investments in limited partnerships, limited liability companies (“LLCs”), and other privately held companies using either the cost or the equity method of accounting. The accounting treatment depends upon the Company’s percentage ownership and degree of management influence.

Under the cost method of accounting, the Company records an investment in stock at cost and generally recognizes cash dividends received as income. If cash dividends received exceed the Company’s relative ownership of the investee’s earnings since the investment date, these payments are considered a return of investment and reduce the cost of the investment.

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Under the equity method of accounting, the Company records its initial investment at cost. Subsequently, the carrying amount of the investment is increased or decreased to reflect the Company's share of income or loss of the investee. The Company's recognition of earnings or losses from an equity method investment is based on the Company's ownership percentage in the investee and the investee's earnings on a quarterly basis. The investees generally provide their financial information during the quarter following the end of a given period. The Company's policy is to record its share of earnings or losses on equity method investments in the quarter the financial information is received.

All of the Company's investments in limited partnerships, LLCs, and other companies are privately held, and their market values are not readily available. The Company's management evaluates its investments in investees for impairment based on the investee's ability to generate cash through its operations or obtain alternative financing, and other subjective factors. There are inherent risks associated with the Company's investments in such companies, which may result in income statement volatility in future periods.

At December 31, 2015 and 2014, the Company's investments in limited partnerships, LLCs and other privately held companies totaled \$2.3 million and \$2.2 million, respectively, and were included in other assets.

**(n) Stock Option Plan** - At December 31, 2015, the Company had three equity-based employee compensation plans, which are described more fully in Note 15. The Company accounts for these plans under the recognition and measurement principles of relevant accounting guidance.

**(o) Per Share Amounts** - Basic Earnings Per Common Share is calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted Earnings Per Common Share is computed by assuming the issuance of common shares for all potentially dilutive common shares outstanding during the reporting period. Currently, the Company's potentially dilutive common stock issuances relate to stock option grants under the Company's equity-based plans and the Company's Series C Preferred stock, which is convertible into common stock on a one-for-one ratio.

In computing Diluted Earnings Per Common Share, adjustments are made to the computation of Basic Earnings Per Common shares, as follows. As it relates to stock options, it is assumed that all dilutive stock options are exercised during the reporting period at their respective exercise prices, with the proceeds from the exercises used by the Company to buy back stock in the open market at the average market price in effect during the reporting period. The difference between the number of shares assumed to be exercised and the number of shares bought back is included in the calculation of dilutive securities. As it relates to the Series C Preferred Stock, it is assumed that the preferred stock was converted to common stock during the reporting period. Dividends on the preferred stock are added back to net income and the shares assumed to be converted are included in the number of shares outstanding.

If any of the potentially dilutive common stock issuances have an anti-dilutive effect, which includes the case when a net loss is reported, the potentially dilutive common stock issuance is disregarded.

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The following is a reconciliation of the numerators and denominators used in computing Basic and Diluted Earnings Per Common Share:

| (\$ in thousands, except per share amounts) | For the Years Ended December 31, |                      |                  |                    |                      |                  |                    |                      |                  |
|---|----------------------------------|----------------------|------------------|--------------------|----------------------|------------------|--------------------|----------------------|------------------|
|   | 2015                             |                      |                  | 2014               |                      |                  | 2013               |                      |                  |
|   | Income (Numerator)               | Shares (Denominator) | Per Share Amount | Income (Numerator) | Shares (Denominator) | Per Share Amount | Income (Numerator) | Shares (Denominator) | Per Share Amount |
| Basic EPS                                   |                                  |                      |                  |                    |                      |                  |                    |                      |                  |
| Net income available to common shareholders | \$26,431                         | 19,767,470           | \$ 1.34          | \$24,128           | 19,699,801           | \$ 1.22          | \$19,804           | 19,675,597           | \$ 1.01          |
| Effect of dilutive securities               | 233                              | 732,257              |                  | 233                | 734,206              |                  | 233                | 728,706              |                  |
| Diluted EPS per common share                | \$26,664                         | 20,499,727           | \$ 1.30          | \$24,361           | 20,434,007           | \$ 1.19          | \$20,037           | 20,404,303           | \$ 0.98          |

For the years ended December 31, 2015, 2014 and 2013, there were 50,000 options, 93,000 options and 388,813 options, respectively, that were anti-dilutive because the exercise price exceeded the average market price for the year, and thus are not included in the calculation to determine the effect of dilutive securities. Also, for both years ended December 31, 2014 and 2013, the Company excluded 75,000 options that had an exercise price below the average market price for the year, but had performance vesting requirements that the Company had concluded were not probable to vest, and ultimately did not vest during 2015.

**(p) Fair Value of Financial Instruments** - Relevant accounting guidance requires that the Company disclose estimated fair values for its financial instruments. Fair value methods and assumptions are set forth below for the Company's financial instruments.

Cash and Amounts Due from Banks, Federal Funds Sold, Presold Mortgages in Process of Settlement, Accrued Interest Receivable, and Accrued Interest Payable - The carrying amounts approximate their fair value because of the short maturity of these financial instruments.

Available for Sale and Held to Maturity Securities - Fair values are provided by a third-party and are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments or matrix pricing.

Loans - For nonimpaired loans, fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, financial and agricultural, real estate construction, real estate mortgages and installment loans to individuals. Each loan category is further segmented into fixed and variable interest rate terms. The fair value for each category is determined by discounting scheduled future cash flows using current interest rates offered on loans with similar risk characteristics. Fair values for impaired loans are primarily based on estimated proceeds expected upon liquidation of the collateral or the present value of expected cash flows.

FDIC Indemnification Asset – Fair value is equal to the FDIC reimbursement rate of the expected losses to be incurred and reimbursed by the FDIC and then discounted over the estimated period of receipt.

Bank-Owned Life Insurance – The carrying value of life insurance approximates fair value because this investment is carried at cash surrender value, as determined by the issuer.

Deposits - The fair value of deposits with no stated maturity, such as noninterest-bearing checking accounts, savings accounts, interest-bearing checking accounts, and money market accounts, is equal to the amount payable on demand as of the valuation date. The fair value of certificates of deposit is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered in the marketplace for deposits of similar remaining maturities.

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**Borrowings** - The fair value of borrowings is based on the discounted value of the contractual cash flows. The discount rate is estimated using the rates currently offered by the Company's lenders for debt of similar maturities.

**Commitments to Extend Credit and Standby Letters of Credit** - At December 31, 2015 and 2014, the Company's off-balance sheet financial instruments had no carrying value. The large majority of commitments to extend credit and standby letters of credit are at variable rates and/or have relatively short terms to maturity. Therefore, the fair value for these financial instruments is considered to be immaterial.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no highly liquid market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on- and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Significant assets and liabilities that are not considered financial assets or liabilities include net premises and equipment, intangible assets and other assets such as foreclosed properties, deferred income taxes, prepaid expense accounts, income taxes currently payable and other various accrued expenses. In addition, the income tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of the estimates.

**(q) Impairment** - Goodwill is evaluated for impairment on at least an annual basis by comparing the fair value of the reporting units to their related carrying value. If the carrying value of a reporting unit exceeds its fair value, the Company determines whether the implied fair value of the goodwill, using various valuation techniques, exceeds the carrying value of the goodwill. If the carrying value of the goodwill exceeds the implied fair value of the goodwill, an impairment loss is recorded in an amount equal to that excess.

The Company reviews all other long-lived assets, including identifiable intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The Company's policy is that an impairment loss is recognized if the sum of the undiscounted future cash flows is less than the carrying amount of the asset. Any long-lived assets to be disposed of are reported at the lower of the carrying amount or fair value, less costs to sell.



To date, the Company has not recorded any impairment write-downs of its long-lived assets or goodwill.

**(r) Comprehensive Income (Loss)** - Comprehensive income (loss) is defined as the change in equity during a period for non-owner transactions and is divided into net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) includes revenues, expenses, gains, and losses that are excluded from earnings under current accounting standards. The components of accumulated other comprehensive income (loss) for the Company are as follows:

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| (\$ in thousands)   | December 31,<br>2015 | December 31,<br>2014 | December 31,<br>2013 |
|---|----------------------|----------------------|----------------------|
| Unrealized gain (loss) on securities available for sale     | \$ (1,163 )          | (691 )               | (2,021 )             |
| Deferred tax asset (liability)                              | 454                  | 270                  | 789                  |
| Net unrealized gain (loss) on securities available for sale | (709 )               | (421 )               | (1,232 )             |
| Additional pension asset (liability)                        | (4,657 )             | (257 )               | 5,135                |
| Deferred tax asset (liability)                              | 1,816                | 100                  | (2,003 )             |
| Net additional pension asset (liability)                    | (2,841 )             | (157 )               | 3,132                |
| Total accumulated other comprehensive income (loss)         | \$ (3,550 )          | (578 )               | 1,900                |

The following table discloses the changes in accumulated other comprehensive income (loss) for the year ended December 31, 2015 (all amounts are net of tax).

| (\$ in thousands)  | Unrealized Gain<br>(Loss) on<br>Securities<br>Available for<br>Sale | Additional<br>Pension<br>Asset<br>(Liability) | Total    |
|--|---|---|----------|
| Beginning balance at January 1, 2015                             | \$ (421 )   | (157 )  | (578 )   |
| Other comprehensive income (loss) before reclassifications       | (289 )  | (2,636 )                                      | (2,925 ) |
| Amounts reclassified from accumulated other comprehensive income | 1   | (48 )   | (47 )    |
| Net current-period other comprehensive income (loss)             | (288 )  | (2,684 )                                      | (2,972 ) |
| Ending balance at December 31, 2015                              | \$ (709 )   | (2,841 )                                      | (3,550 ) |

The following table discloses the changes in accumulated other comprehensive income (loss) for the year ended December 31, 2014 (all amounts are net of tax).

| (\$ in thousands)  | Unrealized Gain<br>(Loss) on<br>Securities<br>Available for<br>Sale | Additional<br>Pension<br>Asset<br>(Liability) | Total    |
|--|---|---|----------|
| Beginning balance at January 1, 2014                             | \$ (1,232 )   | 3,132   | 1,900    |
| Other comprehensive income (loss) before reclassifications       | 1,290   | (3,154 )                                      | (1,864 ) |
| Amounts reclassified from accumulated other comprehensive income | (479 )  | (135 )  | (614 )   |
| Net current-period other comprehensive income (loss)             | 811   | (3,289 )                                      | (2,478 ) |
| Ending balance at December 31, 2014                              | \$ (421 )   | (157 )  | (578 )   |

**(s) Segment Reporting** - Accounting standards require management to report selected financial and descriptive information about reportable operating segments. The standards also require related disclosures about products and services, geographic areas, and major customers. Generally, disclosures are required for segments internally identified to evaluate performance and resource allocation. The Company's operations are primarily within the banking segment, and the financial statements presented herein reflect the results of that segment. The Company has no foreign operations or customers.

**(t) Reclassifications** - Certain amounts for prior years have been reclassified to conform to the 2015 presentation. The reclassifications had no effect on net income or shareholders' equity as previously presented, nor did they materially impact trends in financial information.

**(u) Recent Accounting Pronouncements** - In January 2014, the FASB amended the Investments—Equity Method and Joint Ventures topic to address accounting for investments in qualified affordable housing projects. If certain conditions are met, the amendments permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects by amortizing the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizing the net investment performance in the income statement as a component of income tax expense (benefit). If those conditions are not met, the investment should be accounted for as an equity method investment or a cost method investment in accordance with existing accounting guidance. The amendments were effective for the Company beginning January 1, 2015 and did not have a material effect on the Company's financial statements.

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In January 2014, the FASB amended the Receivables topic of the Accounting Standards Codification. The amendments are intended to resolve diversity in practice with respect to when a creditor should reclassify a collateralized consumer mortgage loan to other real estate owned (“OREO”). In addition, the amendments require a creditor to reclassify a collateralized consumer mortgage loan to OREO upon obtaining legal title to the real estate collateral, or the borrower voluntarily conveying all interest in the real estate property to the lender to satisfy the loan through a deed in lieu of foreclosure or similar legal agreement. The amendments were effective for the Company beginning January 1, 2015. In implementing this guidance, assets that are reclassified from real estate to loans are measured at the carrying value of the real estate at the date of adoption. Assets reclassified from loans to real estate are measured at the lower of the net amount of the loan receivable or the fair value of the real estate less costs to sell at the date of adoption. The Company can apply these amendments either prospectively or using a modified retrospective approach. The adoption of these amendments did not have a material effect on the Company’s financial statements.

In May 2014 and August 2015, the FASB issued guidance to change the recognition of revenue from contracts with customers. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The guidance will be effective for the Company for reporting periods beginning after December 15, 2017. The Company can apply the guidance using either the full retrospective approach or a modified retrospective approach. The Company does not expect this guidance to have a material effect on its financial statements.

In June 2014, the FASB issued guidance which makes limited amendments to the guidance on accounting for certain repurchase agreements. The new guidance (1) requires entities to account for repurchase-to-maturity transactions as secured borrowings (rather than as sales with forward repurchase agreements), (2) eliminates accounting guidance on linked repurchase financing transactions, and (3) expands disclosure requirements related to certain transfers of financial assets that are accounted for as sales and certain transfers (specifically, repos, securities lending transactions, and repurchase-to-maturity transactions) accounted for as secured borrowings. The amendments were effective for the Company beginning January 1, 2015 and did not have a material effect on its financial statements.

In June 2014, the FASB issued guidance which clarifies that performance targets associated with stock compensation should be treated as a performance condition and should not be reflected in the grant date fair value of the stock award. The amendments will be effective for the Company for fiscal years that begin after December 15, 2015. The Company will apply the guidance to all stock awards granted or modified after the amendments are effective. The Company does not expect this guidance to have a material effect on its financial statements.

In August 2014, the FASB amended guidance to eliminate the diversity in the classification of foreclosed mortgage loans when the loan is guaranteed under certain government-sponsored loan guarantee programs. The amendments were effective for the Company beginning on January 1, 2015 and did not have material effect on its financial statements.

In August 2014, the FASB issued guidance that is intended to define management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures. In connection with preparing financial statements, management will need to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the organization's ability to continue as a going concern within one year after the date that the financial statements are issued. The amendments will be effective for the Company for the annual period ending after December 15, 2016, and for annual and interim periods thereafter. The Company does not expect these amendments to have a material effect on its financial statements.

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In January 2015, the FASB issued guidance that eliminated the concept of extraordinary items from U.S. GAAP. Existing U.S. GAAP required that an entity separately classify, present, and disclose extraordinary events and transactions. The amendments will eliminate the requirements for reporting entities to consider whether an underlying event or transaction is extraordinary, however, the presentation and disclosure guidance for items that are unusual in nature or occur infrequently will be retained and will be expanded to include items that are both unusual in nature and infrequently occurring. The amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The amendments may be applied either prospectively or retrospectively to all prior periods presented in the financial statements. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The Company does not expect these amendments to have a material effect on its financial statements.

In February 2015, the FASB issued guidance which amends the consolidation requirements and significantly changes the consolidation analysis required under U.S. GAAP. The amendments are expected to result in the deconsolidation of many entities. The amendments will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015, with early adoption permitted (including during an interim period), provided that the guidance is applied as of the beginning of the annual period containing the adoption date. The Company does not expect these amendments to have a material effect on its financial statements.

In April 2015, the FASB issued guidance that will require debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. This update affects disclosures related to debt issuance costs but does not affect existing recognition and measurement guidance for these items. The amendments will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015, with early adoption permitted. The Company does not expect these amendments to have a material effect on its financial statements.

In April 2015, the FASB issued guidance which provides a practical expedient that permits the Company to measure defined benefit plan assets and obligations using the month-end that is closest to the Company's fiscal year-end. The amendments will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015, with early adoption permitted. The Company does not expect these amendments to have a material effect on its financial statements.

In June 2015, the FASB issued amendments to clarify the Accounting Standards Codification, correct unintended application of guidance, and make minor improvements that are not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities. The amendments were effective upon issuance (June 12, 2015) for amendments that do not have transition guidance. Amendments that are subject to transition guidance will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. The Company does not expect these amendments to have a material effect on its financial statements.

In August 2015, the FASB issued amendments to the Interest topic of the Accounting Standards Codification to clarify the SEC staff's position on presenting and measuring debt issuance costs incurred in connection with line-of-credit arrangements. The amendments were effective upon issuance. The Company does not expect these amendments to have a material effect on its financial statements.

In January 2016, the FASB issued guidance that will require entities to measure equity investments that do not result in consolidation and are not accounted for under the equity method at fair value. Any changes in fair value will be recognized in net income unless the investments qualify for a new practicability exception. This guidance also requires entities to recognize changes in instrument-specific credit risk related to financial liabilities measured under the fair value option in other comprehensive income. No changes were made to the guidance for classifying and measuring investments in debt securities and loans. This guidance is effective for annual and interim periods beginning after December 15, 2017. Management does not expect the adoption of this guidance will have a material effect on its financial statements.

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In February 2016, the FASB issued new guidance on accounting for leases, which generally requires all leases to be recognized in the statement of financial position. The provisions of this guidance are effective for reporting periods beginning after December 15, 2018; early adoption is permitted. These provisions are to be applied using a modified retrospective approach. We are currently evaluating the effect that this ASU will have on our consolidated financial statements. The Company does not expect this guidance to have a material effect on its financial statements.

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.

**Note 2. Acquisitions**

The Company completed the acquisition described below in 2013. The Company did not complete any acquisitions in 2014 or 2015. The results of each acquired company/branch are included in the Company's results beginning on its respective acquisition date.

(1) On March 22, 2013, the Company completed the purchase of two branches from Four Oaks Bank & Trust Company located in Southern Pines and Rockingham, North Carolina. The Company acquired \$57 million in deposits and \$16 million in loans in the acquisition. The Company purchased the Rockingham branch building, but did not purchase the Southern Pines branch building and instead transferred the acquired accounts to one of the Company's nearby existing branches. The primary reason for this acquisition was to increase the Company's presence in existing market areas. The Company paid a deposit premium for the branches of approximately \$586,000, which is the amount of the identifiable intangible asset associated with the fair value of the core deposit base. The intangible asset is being amortized as expense on a straight-line basis over a seven year period. The operations of the two branches are included in the accompanying Consolidated Statements of Income beginning on the acquisition date of March 22, 2013. Historical pro forma information is not presented due to the immateriality of the transaction.



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The book values and approximate fair values of investment securities at December 31, 2015 and 2014 are summarized as follows:

| (\$ in thousands)                          | 2015           |            |                  |                     | 2014           |            |                  |                     |
|--|----------------|------------|------------------|---------------------|----------------|------------|------------------|---------------------|
|  | Amortized Cost | Fair Value | Unrealized Gains | Unrealized (Losses) | Amortized Cost | Fair Value | Unrealized Gains | Unrealized (Losses) |
| Securities available for sale:             |                |            |                  |                     |                |            |                  |                     |
| Government-sponsored enterprise securities | \$ 19,000      | 18,972     | 1                | (29 )               | 27,546         | 27,521     | 33               | (58 )               |
| Mortgage-backed securities                 | 122,474        | 121,553    | 348              | (1,269 )            | 130,073        | 129,510    | 751              | (1,314 )            |
| Corporate bonds                            | 25,216         | 24,946     | —                | (270 )              | 1,000          | 865        | —                | (135 )              |
| Equity securities                          | 88             | 143        | 64               | (9 )                | 89             | 122        | 46               | (13 )               |
| Total available for sale                   | \$ 166,778     | 165,614    | 413              | (1,577 )            | 158,708        | 158,018    | 830              | (1,520 )            |
| Securities held to maturity:               |                |            |                  |                     |                |            |                  |                     |
| Mortgage-backed securities                 | \$ 102,509     | 101,767    | —                | (742 )              | 124,924        | 124,861    | 45               | (108 )              |
| State and local governments                | 52,101         | 55,379     | 3,284            | (6 )                | 53,763         | 57,550     | 3,787            | —                   |
| Total held to maturity                     | \$ 154,610     | 157,146    | 3,284            | (748 )              | 178,687        | 182,411    | 3,832            | (108 )              |

Included in mortgage-backed securities at December 31, 2015 were collateralized mortgage obligations with an amortized cost of \$34,500 and a fair value of \$34,800. Included in mortgage-backed securities at December 31, 2014 were collateralized mortgage obligations with an amortized cost of \$108,000 and a fair value of \$111,000. All of the Company's mortgage-backed securities, including the collateralized mortgage obligations, were issued by government-sponsored corporations.

The following table presents information regarding securities with unrealized losses at December 31, 2015:

| (\$ in thousands)                          | Securities in an Unrealized Loss Position for Less than 12 Months |                   | Securities in an Unrealized Loss Position for More than 12 Months |                   | Total      |                   |
|--|---|-------------------|---|-------------------|------------|-------------------|
|  | Fair Value  | Unrealized Losses | Fair Value  | Unrealized Losses | Fair Value | Unrealized Losses |
| Government-sponsored enterprise securities | \$ 5,993  | 7                 | 2,978   | 22                | 8,971      | 29                |
| Mortgage-backed securities                 | 150,853   | 1,148             | 27,460  | 863               | 178,313    | 2,011             |
| Corporate bonds                            | 24,006  | 210               | 940   | 60                | 24,946     | 270               |

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|                                       |            |       |        |     |         |       |
|---------------------------------------|------------|-------|--------|-----|---------|-------|
| Equity securities                     | —          | —     | 17     | 9   | 17      | 9     |
| State and local governments           | 840        | 6     | —      | —   | 840     | 6     |
| Total temporarily impaired securities | \$ 181,692 | 1,371 | 31,395 | 954 | 213,087 | 2,325 |

The following table presents information regarding securities with unrealized losses at December 31, 2014:

| (\$ in thousands)                          | Securities in an<br>Unrealized<br>Loss Position for<br>Less than 12 Months |                      | Securities in an<br>Unrealized<br>Loss Position for<br>More than 12 Months |                      | Total         |                      |
|--|--|----------------------|--|----------------------|---------------|----------------------|
|  | Fair Value   | Unrealized<br>Losses | Fair Value   | Unrealized<br>Losses | Fair<br>Value | Unrealized<br>Losses |
| Government-sponsored enterprise securities | \$ 5,489   | 11                   | 2,953  | 47                   | 8,442         | 58                   |
| Mortgage-backed securities                 | 69,985   | 318                  | 33,557   | 1,104                | 103,542       | 1,422                |
| Corporate bonds                            | —  | —                    | 865  | 135                  | 865           | 135                  |
| Equity securities                          | —  | —                    | 17   | 13                   | 17            | 13                   |
| State and local governments                | —  | —                    | —  | —                    | —             | —                    |
| Total temporarily impaired securities      | \$ 75,474  | 329                  | 37,392   | 1,299                | 112,866       | 1,628                |

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In the above tables, all of the non-equity securities that were in an unrealized loss position at December 31, 2015 and 2014 are bonds that the Company has determined are in a loss position due primarily to interest rate factors and not credit quality concerns. The Company has evaluated the collectability of each of these bonds and has concluded that there is no other-than-temporary impairment. The Company does not intend to sell these securities, and it is more likely than not that the Company will not be required to sell these securities before recovery of the amortized cost.

The Company has concluded that each of the equity securities in an unrealized loss position at December 31, 2015 and 2014 was in such a position due to temporary fluctuations in the market prices of the securities. The Company's policy is to record an impairment charge for any of these equity securities that remains in an unrealized loss position for twelve consecutive months unless the amount is insignificant.

The book values and approximate fair values of investment securities at December 31, 2015, by contractual maturity, are summarized in the table below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

| (\$ in thousands)                         | Securities Available for Sale |            | Securities Held to Maturity |            |
|---|-------------------------------|------------|-----------------------------|------------|
|   | Amortized Cost                | Fair Value | Amortized Cost              | Fair Value |
| Debt securities                           |                               |            |                             |            |
| Due within one year                       | \$ —                          | —          | \$ 835                      | 839        |
| Due after one year but within five years  | 19,000                        | 18,972     | 12,549                      | 13,190     |
| Due after five years but within ten years | 20,216                        | 20,026     | 37,286                      | 39,919     |
| Due after ten years                       | 5,000                         | 4,920      | 1,431                       | 1,431      |
| Mortgage-backed securities                | 122,474                       | 121,553    | 102,509                     | 101,767    |
| Total debt securities                     | 166,690                       | 165,471    | 154,610                     | 157,146    |
| Equity securities                         | 88                            | 143        | —                           | —          |
| Total securities                          | \$ 166,778                    | 165,614    | \$ 154,610                  | 157,146    |

At December 31, 2015 and 2014, investment securities with carrying values of \$141,379,000 and \$100,113,000, respectively, were pledged as collateral for public deposits.

In 2015, the Company recorded \$1,000 in securities losses associated with write-downs and did not sell any securities. In 2014 and 2013, the Company initiated security sales totaling \$47,473,000 and \$12,908,000, respectively, which resulted in net gains of \$786,000 and \$525,000 in 2014 and 2013, respectively.

The aggregate carrying amount of cost-method investments was \$15,893,000 and \$6,016,000 at December 31, 2015 and 2014, respectively, which is recorded within the line item “other assets” on the Company’s Consolidated Balance Sheets. These investments are comprised of Federal Home Loan Bank (“FHLB”) stock and Federal Reserve Bank of Richmond (“FRB”) stock. The FHLB stock had a cost and fair value of \$8,846,000 and \$6,016,000 at December 31, 2015 and 2014, respectively, and serves as part of the collateral for the Company’s line of credit with the FHLB and is also a requirement for membership in the FHLB system. The FRB stock had a cost and fair value of \$7,047,000 at December 31, 2015. The Company was required to purchase this stock when it became a member of the Federal Reserve System in the second quarter of 2015. Periodically, both the FHLB and FRB recalculate the Company’s required level of holdings, and the Company either buys more stock or the redeems a portion of the stock at cost. The Company determined that neither stock was impaired at either period end.

Table of Contents**Note 4. Loans and Asset Quality Information**

The loans and foreclosed real estate that were acquired in FDIC-assisted transactions are covered by loss share agreements between the FDIC and the Company's banking subsidiary, First Bank, which afford First Bank significant loss protection - see Note 2 to the financial statements included in the Company's 2011 Annual Report on Form 10-K filed with the SEC for detailed information regarding these transactions. Because of the loss protection provided by the FDIC, the risk of the loans and foreclosed real estate that are covered by loss share agreements are significantly different from those assets not covered under the loss share agreements. Accordingly, the Company presents separately loans subject to the loss share agreements as "covered loans" in the information below and loans that are not subject to the loss share agreements as "non-covered loans."

On July 1, 2014, one of the Company's loss share agreements with the FDIC expired. The agreement that expired related to the non-single family assets of Cooperative Bank, a failed bank acquisition from June 2009. Accordingly, the remaining balances associated with these loans and foreclosed real estate were transferred from the covered portfolio to the non-covered portfolio on July 1, 2014. The Company bears all future losses on this portfolio of loans and foreclosed real estate. Immediately prior to the transfer to non-covered status, the loans in this portfolio had a carrying value of \$39.7 million and the foreclosed real estate in this portfolio had a carrying value of \$3.0 million. Of the \$39.7 million in loans that lost loss share protection, approximately \$9.7 million were on nonaccrual status and \$2.1 million were classified as accruing troubled debt restructurings as of July 1, 2014. Additionally, approximately \$1.7 million in allowance for loan losses associated with this portfolio of loans was transferred to the allowance for loan losses for non-covered loans on July 1, 2014.

The following is a summary of the major categories of total loans outstanding:

| (\$ in thousands)   | December 31, 2015 |            | December 31, 2014 |            |
|---|-------------------|------------|-------------------|------------|
|   | Amount            | Percentage | Amount            | Percentage |
| All loans (non-covered and covered):                              |                   |            |                   |            |
| Commercial, financial, and agricultural                           | \$202,671         | 8%         | \$160,878         | 7%         |
| Real estate – construction, land development & other land loans   | 308,969           | 12%        | 288,148           | 12%        |
| Real estate – mortgage – residential (1-4 family) first mortgages | 768,559           | 31%        | 789,871           | 33%        |
| Real estate – mortgage – home equity loans / lines of credit      | 232,601           | 9%         | 223,500           | 9%         |
| Real estate – mortgage – commercial and other                     | 957,587           | 38%        | 882,127           | 37%        |
| Installment loans to individuals                                  | 47,666            | 2%         | 50,704            | 2%         |
| Subtotal  | 2,518,053         | 100%       | 2,395,228         | 100%       |
| Unamortized net deferred loan costs                               | 873               |            | 946               |            |
| Total loans   | \$2,518,926       |            | \$2,396,174       |            |

Loans in the amount of \$2.0 billion and \$1.9 billion were pledged as collateral for certain borrowings as of December 31, 2015 and December 31, 2014, respectively (see Note 10).

The loans above also include loans to executive officers and directors serving the Company at December 31, 2015 and to their associates, totaling approximately \$3.4 million and \$3.8 million at December 31, 2015 and 2014, respectively. During 2015 additions to such loans were approximately \$0.9 million and repayments totaled approximately \$1.3 million. These loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other non-related borrowers. Management does not believe these loans involve more than the normal risk of collectability or present other unfavorable features.

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The following is a summary of the major categories of non-covered loans outstanding:

| (\$ in thousands)   | December 31, 2015 |            | December 31, 2014 |            |
|---|-------------------|------------|-------------------|------------|
|   | Amount            | Percentage | Amount            | Percentage |
| Non-covered loans:  |                   |            |                   |            |
| Commercial, financial, and agricultural                           | \$201,798         | 8%         | \$159,195         | 7%         |
| Real estate – construction, land development & other land loans   | 305,228           | 13%        | 282,604           | 13%        |
| Real estate – mortgage – residential (1-4 family) first mortgages | 692,902           | 29%        | 700,101           | 31%        |
| Real estate – mortgage – home equity loans / lines of credit      | 221,995           | 9%         | 210,697           | 9%         |
| Real estate – mortgage – commercial and other                     | 945,823           | 39%        | 864,333           | 38%        |
| Installment loans to individuals                                  | 47,666            | 2%         | 50,704            | 2%         |
| Subtotal  | 2,415,412         | 100%       | 2,267,634         | 100%       |
| Unamortized net deferred loan costs                               | 873               |            | 946               |            |
| Total non-covered loans   | \$2,416,285       |            | \$2,268,580       |            |

The carrying amount of the covered loans at December 31, 2015 consisted of impaired and nonimpaired purchased loans (as determined on the date of acquisition), as follows:

| (\$ in thousands)   | Impaired                                  |   | Nonimpaired                                  |  | Total Covered Loans – Carrying Value | Total Covered Loans – Unpaid Principal Balance |
|---|---|---|--|--|--------------------------------------|--|
|   | Impaired Purchased Loans – Carrying Value | Impaired Purchased Loans – Unpaid Principal Balance | Nonimpaired Purchased Loans – Carrying Value | Nonimpaired Purchased Loans – Unpaid Principal Balance |                                      |  |
| Covered loans:  |   |   |  |  |                                      |  |
| Commercial, financial, and agricultural                           | \$—                                       | —   | 873  | 886  | 873                                  | 886  |
| Real estate – construction, land development & other land loans   | 277                                       | 365   | 3,464  | 3,457  | 3,741                                | 3,822  |
| Real estate – mortgage – residential (1-4 family) first mortgages | 102                                       | 633   | 75,555                                       | 88,434   | 75,657                               | 89,067   |
| Real estate – mortgage – home equity loans / lines of credit      | 7   | 14  | 10,599                                       | 12,099   | 10,606                               | 12,113   |
| Real estate – mortgage – commercial and other                     | 1,003                                     | 3,136   | 10,761                                       | 11,458   | 11,764                               | 14,594   |
| Total   | \$1,389                                   | 4,148   | 101,252                                      | 116,334  | 102,641                              | 120,482  |

The carrying amount of the covered loans at December 31, 2014 consisted of impaired and nonimpaired purchased loans (as determined on the date of acquisition), as follows:

| Impaired Purchased Loans – Carrying | Impaired Purchased Loans – Unpaid | Nonimpaired Purchased Loans – Carrying | Nonimpaired Purchased Loans – Unpaid | Total Covered Loans – Carrying | Total Covered Loans – Unpaid |
|-------------------------------------|-----------------------------------|--|--------------------------------------|--------------------------------|------------------------------|
|-------------------------------------|-----------------------------------|--|--------------------------------------|--------------------------------|------------------------------|

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| <i>(\$ in thousands)</i>  | Value   | Unpaid Value | Principal | Value   | Principal |
|---|---------|--------------|-----------|---------|-----------|
|   |         | Principal    | Balance   |         | Balance   |
|   |         | Balance      |           |         |           |
| Covered loans:  |         |              |           |         |           |
| Commercial, financial, and agricultural                           | \$66    | 123          | 1,617     | 1,661   | 1,784     |
| Real estate – construction, land development & other land loans   | 309     | 534          | 5,235     | 6,471   | 7,005     |
| Real estate – mortgage – residential (1-4 family) first mortgages | 362     | 1,298        | 89,408    | 104,678 | 105,976   |
| Real estate – mortgage – home equity loans / lines of credit      | 12      | 19           | 12,791    | 15,099  | 15,118    |
| Real estate – mortgage – commercial and other                     | 1,201   | 3,209        | 16,593    | 17,789  | 20,998    |
| Total   | \$1,950 | 5,183        | 125,644   | 145,698 | 150,881   |



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The following table presents information regarding covered purchased nonimpaired loans since December 31, 2013. The amounts include principal only and do not reflect accrued interest as of the date of the acquisition or beyond.

*(\$ in thousands)*

|  |           |
|--|-----------|
| Carrying amount of nonimpaired covered loans at December 31, 2013        | \$207,167 |
| Principal repayments   | (50,183 ) |
| Transfers to foreclosed real estate                                      | (5,061 )  |
| Transfers to non-covered loans due to expiration of loss-share agreement | (38,987 ) |
| Net loan (charge-offs) / recoveries                                      | (3,301 )  |
| Accretion of loan discount   | 16,009    |
| Carrying amount of nonimpaired covered loans at December 31, 2014        | 125,644   |
| Principal repayments   | (30,238 ) |
| Transfers to foreclosed real estate                                      | (1,211 )  |
| Net loan (charge-offs) / recoveries                                      | 2,306     |
| Accretion of loan discount   | 4,751     |
| Carrying amount of nonimpaired covered loans at December 31, 2015        | \$101,252 |

As reflected in the table above, the Company accreted \$4,751,000 and \$16,009,000 of the loan discount on purchased nonimpaired loans into interest income during 2015 and 2014, respectively. As of December 31, 2015, there was remaining loan discount of \$13,086,000 related to purchased accruing loans. If these loans continue to be repaid by the borrowers, the Company will accrete the remaining loan discount into interest income over the covered lives of the respective loans. In such circumstances, a corresponding entry to reduce the indemnification asset will be recorded amounting to approximately 80% of the loan discount accretion, which reduces noninterest income. At December 31, 2015, the Company also had \$2,174,000 of loan discount related to purchased nonaccruing loans. It is not expected that a significant amount of this discount will be accreted, as it represents estimated losses on these loans.

The following table presents information regarding all purchased impaired loans since December 31, 2013, the majority of which are covered loans. The Company has applied the cost recovery method to all purchased impaired loans at their respective acquisition dates due to the uncertainty as to the timing of expected cash flows, as reflected in the following table.

| <i>(\$ in thousands)</i> | Contractual<br>Principal<br>Receivable | Fair Market<br>Value<br>Adjustment –<br>Write Down<br>(Nonaccretable<br>Difference) | Carrying<br>Amount |
|--------------------------|--|---|--------------------|
|--------------------------|--|---|--------------------|

## Purchased Impaired Loans

|                                    |          |        |        |
|------------------------------------|----------|--------|--------|
| Balance at December 31, 2013       | \$ 6,263 | 3,121  | 3,142  |
| Change due to payments received    | (599 )   | 227    | (826 ) |
| Change due to loan charge-off      | (2 )     | 29     | (31 )  |
| Other                              | 197      | (115 ) | 312    |
| Balance at December 31, 2014       | \$ 5,859 | 3,262  | 2,597  |
| Change due to payments received    | (634 )   | (102 ) | (532 ) |
| Transfer to foreclosed real estate | (431 )   | (336 ) | (95 )  |
| Other                              | (3 )     | (3 )   | —      |
| Balance at December 31, 2015       | \$ 4,791 | 2,821  | 1,970  |

Because of the uncertainty of the expected cash flows, the Company is accounting for each purchased impaired loan under the cost recovery method, in which all cash payments are applied to principal. Thus, there is no accretable yield associated with the above loans. During 2015 and 2014, the Company received \$436,000 and \$179,000, respectively, in payments that exceeded the initial carrying amount of the purchased impaired loans, which is included in interest income.

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Nonperforming assets are defined as nonaccrual loans, restructured loans, loans past due 90 or more days and still accruing interest, nonperforming loans held for sale, and foreclosed real estate. Nonperforming assets are summarized as follows:

| <b>ASSET QUALITY DATA</b> ( <i>\$ in thousands</i> ) | December 31,<br>2015 | December 31,<br>2014 |
|--|----------------------|----------------------|
| Non-covered nonperforming assets                     |                      |                      |
| Nonaccrual loans                                     | \$ 39,994            | 50,066               |
| Restructured loans – accruing                        | 28,011               | 35,493               |
| Accruing loans > 90 days past due                    | —                    | —                    |
| Total non-covered nonperforming loans                | 68,005               | 85,559               |
| Foreclosed real estate                               | 9,188                | 9,771                |
| Total non-covered nonperforming assets               | \$ 77,193            | 95,330               |
| Covered nonperforming assets                         |                      |                      |
| Nonaccrual loans (1)                                 | \$ 7,816             | 10,508               |
| Restructured loans – accruing                        | 3,478                | 5,823                |
| Accruing loans > 90 days past due                    | —                    | —                    |
| Total covered nonperforming loans                    | 11,294               | 16,331               |
| Foreclosed real estate                               | 806                  | 2,350                |
| Total covered nonperforming assets                   | \$ 12,100            | 18,681               |
| <br>Total nonperforming assets                       | <br>\$ 89,293        | <br>114,011          |

(1) At December 31, 2015 and December 31, 2014, the contractual balance of the nonaccrual loans covered by FDIC loss share agreements was \$12.3 million and \$16.0 million, respectively.

At December 31, 2015 and 2014, the Company had \$2.5 million and \$6.1 million in residential mortgage loans in process of foreclosure, respectively.

If the nonaccrual and restructured loans as of December 31, 2015, 2014 and 2013 had been current in accordance with their original terms and had been outstanding throughout the period (or since origination if held for part of the period), gross interest income in the amounts of approximately \$3,213,000, \$4,115,000, and \$5,262,000 for nonaccrual loans and \$2,044,000, \$3,045,000, and \$2,674,000 for restructured loans would have been recorded for 2015, 2014, and 2013, respectively. Interest income on such loans that was actually collected and included in net income in 2015, 2014 and 2013 amounted to approximately \$575,000, \$1,176,000, and \$1,414,000 for nonaccrual loans (prior to their being placed on nonaccrual status), and \$1,392,000, \$2,003,000, and \$1,681,000 for restructured loans, respectively. At December 31, 2015 and 2014, we had no commitments to lend additional funds to debtors whose loans were nonperforming.

The remaining tables in this note present information derived from the Company's allowance for loan loss model. Relevant accounting guidance requires certain disclosures to be disaggregated based on how the Company develops its allowance for loan losses and manages its credit exposure. This model combines loan types in a different manner than the tables previously presented.

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The following table presents the Company's nonaccrual loans as of December 31, 2015.

| (\$ in thousands)   | Non-covered | Covered | Total  |
|---|-------------|---------|--------|
| Commercial, financial, and agricultural:                        |             |         |        |
| Commercial – unsecured  | \$ 391      | 22      | 413    |
| Commercial – secured  | 2,406       | —       | 2,406  |
| Secured by inventory and accounts receivable                    | 83          | —       | 83     |
| Real estate – construction, land development & other land loans | 4,155       | 52      | 4,207  |
| Real estate – residential, farmland and multi-family            | 21,964      | 5,201   | 27,165 |
| Real estate – home equity lines of credit                       | 2,431       | 361     | 2,792  |
| Real estate – commercial  | 8,262       | 2,180   | 10,442 |
| Consumer  | 302         | —       | 302    |
| Total   | \$ 39,994   | 7,816   | 47,810 |

The following table presents the Company's nonaccrual loans as of December 31, 2014.

| (\$ in thousands)   | Non-covered | Covered | Total  |
|---|-------------|---------|--------|
| Commercial, financial, and agricultural:                        |             |         |        |
| Commercial – unsecured  | \$ 187      | 1       | 188    |
| Commercial – secured  | 2,927       | —       | 2,927  |
| Secured by inventory and accounts receivable                    | 454         | 103     | 557    |
| Real estate – construction, land development & other land loans | 7,891       | 1,140   | 9,031  |
| Real estate – residential, farmland and multi-family            | 24,459      | 7,785   | 32,244 |
| Real estate – home equity lines of credit                       | 2,573       | 278     | 2,851  |
| Real estate – commercial  | 11,070      | 1,201   | 12,271 |
| Consumer  | 505         | —       | 505    |
| Total   | \$ 50,066   | 10,508  | 60,574 |



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The following table presents an analysis of the payment status of the Company's loans as of December 31, 2015.

| (\$ in thousands)   | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past<br>Due | Nonaccrual<br>Loans | Current   | Total<br>Loans<br>Receivable |
|---|------------------------------|------------------------------|---------------------|-----------|------------------------------|
| Non-covered loans   |                              |                              |                     |           |                              |
| Commercial, financial, and agricultural:                        |                              |                              |                     |           |                              |
| Commercial - unsecured  | \$632                        | —                            | 391                 | 50,878    | 51,901                       |
| Commercial - secured  | 344                          | 127                          | 2,406               | 111,803   | 114,680                      |
| Secured by inventory and accounts receivable                    | 28                           | —                            | 83                  | 38,875    | 38,986                       |
| Real estate – construction, land development & other land loans | 1,499                        | 379                          | 4,155               | 284,345   | 290,378                      |
| Real estate – residential, farmland, and multi-family           | 12,691                       | 3,271                        | 21,964              | 813,817   | 851,743                      |
| Real estate – home equity lines of credit                       | 920                          | 96                           | 2,431               | 207,998   | 211,445                      |
| Real estate - commercial  | 5,399                        | 864                          | 8,262               | 797,855   | 812,380                      |
| Consumer  | 273                          | 255                          | 302                 | 43,069    | 43,899                       |
| Total non-covered   | \$21,786                     | 4,992                        | 39,994              | 2,348,640 | 2,415,412                    |
| Unamortized net deferred loan costs                             |                              |                              |                     |           | 873                          |
| Total non-covered loans   |                              |                              |                     |           | \$2,416,285                  |
| Covered loans   | \$3,313                      | 402                          | 7,816               | 91,110    | 102,641                      |
| Total loans   | \$25,099                     | 5,394                        | 47,810              | 2,439,750 | 2,518,926                    |

The Company had no non-covered or covered loans that were past due greater than 90 days and accruing interest at December 31, 2015.

The following table presents an analysis of the payment status of the Company's loans as of December 31, 2014.

| (\$ in thousands)                        | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past<br>Due | Nonaccrual<br>Loans | Current | Total<br>Loans<br>Receivable |
|--|------------------------------|------------------------------|---------------------|---------|------------------------------|
| Non-covered loans                        |                              |                              |                     |         |                              |
| Commercial, financial, and agricultural: |                              |                              |                     |         |                              |

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|   |          |       |        |           |             |
|---|----------|-------|--------|-----------|-------------|
| Commercial - unsecured  | \$191    | 35    | 187    | 36,871    | 37,284      |
| Commercial - secured  | 1,003    | 373   | 2,927  | 102,671   | 106,974     |
| Secured by inventory and accounts receivable                    | 30       | 225   | 454    | 21,761    | 22,470      |
| Real estate – construction, land development & other land loans | 1,950    | 139   | 7,891  | 247,535   | 257,515     |
| Real estate – residential, farmland, and multi-family           | 11,272   | 3,218 | 24,459 | 807,884   | 846,833     |
| Real estate – home equity lines of credit                       | 1,585    | 352   | 2,573  | 194,067   | 198,577     |
| Real estate - commercial  | 3,738    | 996   | 11,070 | 738,981   | 754,785     |
| Consumer  | 695      | 131   | 505    | 41,865    | 43,196      |
| Total non-covered   | \$20,464 | 5,469 | 50,066 | 2,191,635 | 2,267,634   |
| Unamortized net deferred loan costs                             |          |       |        |           | 946         |
| Total non-covered loans   |          |       |        |           | \$2,268,580 |
| Covered loans   | \$4,385  | 964   | 10,508 | 111,737   | 127,594     |
| Total loans   | \$24,849 | 6,433 | 60,574 | 2,303,372 | 2,396,174   |

The Company had no non-covered or covered loans that were past due greater than 90 days and accruing interest at December 31, 2014.



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The following table presents the activity in the allowance for loan losses for non-covered loans for the year ended December 31, 2015.

| (\$ in thousands)  | Commercial<br>Financial,<br>and<br>Agricultural | Real<br>Estate –<br>Construction<br>Land<br>Development<br>&<br>Other<br>Land<br>Loans | Real<br>Estate –<br>Residential<br>Farmland,<br>and<br>Multi-<br>family | Real<br>Estate –<br>Home<br>Equity<br>Lines of<br>Credit | Real<br>Estate –<br>Commercial<br>and<br>Other | Consumer | Unallo-<br>cated | Total     |
|--|---|--|---|--|--|----------|------------------|-----------|
| As of and for the year ended December 31, 2015                     |   |  |   |  |  |          |                  |           |
| Beginning balance  | \$8,391   | 6,470  | 9,720   | 3,731  | 9,045  | 841      | 147              | 38,305    |
| Charge-offs  | (3,684 )  | (2,647 )   | (5,682 )  | (826 )   | (2,639 )                                       | (1,637 ) | —                | (17,915 ) |
| Recoveries   | 876   | 993  | 321   | 100  | 888  | 368      | —                | 3,546     |
| Provisions   | (825 )  | (1,406 )   | 4,795   | (264 )   | (2,307 )                                       | 1,466    | 549              | 2,008     |
| Ending balance   | \$4,758   | 3,410  | 9,154   | 2,741  | 4,987  | 1,038    | 696              | 26,777    |
| Ending balances as of December 31, 2015: Allowance for loan losses |   |  |   |  |  |          |                  |           |
| Individually evaluated for impairment                              | \$190   | 213  | 1,478   | 313  | 333  | 160      | —                | 2,687     |
| Collectively evaluated for impairment                              | \$4,568   | 3,197  | 7,676   | 2,428  | 4,654  | 878      | 696              | 24,090    |
| Loans acquired with deteriorated credit quality                    | \$—   | —  | —   | —  | —  | —        | —                | —         |
| Loans receivable as of December 31, 2015:                          |   |  |   |  |  |          |                  |           |
| Ending balance   | \$205,567                                       | 290,378  | 851,743   | 211,445  | 812,380  | 43,899   | —                | 2,415,412 |
| Unamortized net deferred loan costs                                |   |  |   |  |  |          |                  | 873       |
| Total non-covered loans  |   |  |   |  |  |          |                  | 2,416,285 |
| Ending balances as of December 31, 2015: Loans                     |   |  |   |  |  |          |                  |           |
| Individually evaluated for impairment                              | \$907   | 4,554  | 23,839  | 376  | 14,818   | 160      | —                | 44,654    |
| Collectively evaluated for impairment                              | \$204,660                                       | 285,824  | 827,904   | 211,069  | 796,981  | 43,739   | —                | 2,370,177 |
| Loans acquired with deteriorated credit quality                    | \$—   | —  | —   | —  | 581  | —        | —                | 581       |

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The following table presents the activity in the allowance for loan losses for non-covered loans for the year ended December 31, 2014.

| (\$ in thousands)  | Commercial<br>Financial,<br>and<br>Agricultural | Real<br>Estate –<br>Construction<br>Land<br>Development<br>&<br>Other<br>Land<br>Loans | Real<br>Estate –<br>Residential<br>Farmland,<br>and<br>Multi-<br>family | Real<br>Estate –<br>Home<br>Equity<br>Lines of<br>Credit | Real<br>Estate –<br>Commercial<br>and<br>Other | Consumer | Unallo-<br>cated | Total     |
|--|---|--|---|--|--|----------|------------------|-----------|
| As of and for the year ended December 31, 2014                     |   |  |   |  |  |          |                  |           |
| Beginning balance  | \$7,432   | 12,966   | 15,142  | 1,838  | 5,524  | 1,513    | (152)            | 44,153    |
| Charge-offs  | (4,039 )  | (2,148 )   | (4,417 )  | (912 )   | (3,048 )                                       | (1,724 ) | —                | (16,288)  |
| Recoveries   | 140   | 398  | 331   | 45   | 181  | 451      | —                | 1,546     |
| Transfer from covered category                                     | 36  | 813  | 51  | —  | 833  | 4        | —                | 1,737     |
| Provisions   | 4,822   | (5,559 )   | (1,387 )  | 2,760  | 5,555  | 597      | 299              | 7,088     |
| Ending balance   | \$8,391   | 6,470  | 9,720   | 3,731  | 9,045  | 841      | 147              | 38,305    |
| Ending balances as of December 31, 2014: Allowance for loan losses |   |  |   |  |  |          |                  |           |
| Individually evaluated for impairment                              | \$211   | 415  | 1,686   | —  | 165  | —        | —                | 2,477     |
| Collectively evaluated for impairment                              | \$8,180   | 6,055  | 8,034   | 3,731  | 8,880  | 841      | 147              | 35,828    |
| Loans acquired with deteriorated credit quality                    | \$—   | —  | —   | —  | —  | —        | —                | —         |
| Loans receivable as of December 31, 2014:                          |   |  |   |  |  |          |                  |           |
| Ending balance   | \$166,728                                       | 257,515  | 846,833   | 198,577  | 754,785  | 43,196   | —                | 2,207,534 |
| Unamortized net deferred loan costs                                | —   | —  | —   | —  | —  | —        | —                | 946       |
| Total non-covered loans  | —   | —  | —   | —  | —  | —        | —                | 2,208,480 |
| Ending balances as of December 31, 2014: Loans                     |   |  |   |  |  |          |                  |           |
| Individually evaluated for impairment                              | \$784   | 7,991  | 24,010  | 476  | 20,263   | 7        | —                | 53,531    |
| Collectively evaluated for impairment                              | \$165,944                                       | 249,524  | 822,823   | 198,101  | 733,875  | 43,189   | —                | 2,200,256 |
| Loans acquired with deteriorated credit quality                    | \$—   | —  | —   | —  | 647  | —        | —                | 647       |

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The following table presents the activity in the allowance for loan losses for covered loans for the year ended December 31, 2015.

| (\$ in thousands)                              | Covered Loans |
|--|---------------|
| As of and for the year ended December 31, 2015 |               |
| Beginning balance                              | \$ 2,281      |
| Charge-offs                                    | (1,316 )      |
| Recoveries                                     | 3,622         |
| Provision (reversal) for loan losses           | (2,788 )      |
| Ending balance                                 | \$ 1,799      |

Ending balances as of December 31, 2015: Allowance for loan losses

|   |        |
|---|--------|
| Individually evaluated for impairment           | \$ 554 |
| Collectively evaluated for impairment           | 1,175  |
| Loans acquired with deteriorated credit quality | 70     |

Loans receivable as of December 31, 2015:

|                        |            |
|------------------------|------------|
| Ending balance – total | \$ 102,641 |
|------------------------|------------|

Ending balances as of December 31, 2015: Loans

|   |          |
|---|----------|
| Individually evaluated for impairment           | \$ 7,055 |
| Collectively evaluated for impairment           | 94,197   |
| Loans acquired with deteriorated credit quality | 1,389    |

The following table presents the activity in the allowance for loan losses for covered loans for the year ended December 31, 2014.

| (\$ in thousands)                              | Covered Loans |
|--|---------------|
| As of and for the year ended December 31, 2014 |               |
| Beginning balance                              | \$ 4,242      |
| Charge-offs                                    | (6,948 )      |
| Recoveries                                     | 3,616         |
| Transferred to non-covered                     | (1,737 )      |
| Provision for loan losses                      | 3,108         |
| Ending balance                                 | \$ 2,281      |

Ending balances as of December 31, 2014: Allowance for loan losses

|   |          |
|---|----------|
| Individually evaluated for impairment           | \$ 1,161 |
| Collectively evaluated for impairment           | 1,046    |
| Loans acquired with deteriorated credit quality | 74       |

Loans receivable as of December 31, 2014:

|                        |            |
|------------------------|------------|
| Ending balance – total | \$ 127,594 |
|------------------------|------------|

Ending balances as of December 31, 2014: Loans

|   |           |
|---|-----------|
| Individually evaluated for impairment           | \$ 11,484 |
| Collectively evaluated for impairment           | 114,160   |
| Loans acquired with deteriorated credit quality | 1,950     |

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The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2015.

| <i>(\$ in thousands)</i>  | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment |
|---|------------------------|--------------------------------|----------------------|-----------------------------------|
| Non-covered loans with no related allowance recorded:           |                        |                                |                      |                                   |
| Commercial, financial, and agricultural:                        |                        |                                |                      |                                   |
| Commercial - unsecured  | \$ 234                 | 276                            | —                    | 128                               |
| Commercial - secured  | 128                    | 151                            | —                    | 70                                |
| Secured by inventory and accounts receivable                    | —                      | —                              | —                    | —                                 |
| Real estate – construction, land development & other land loans | 3,922                  | 7,397                          | —                    | 4,557                             |
| Real estate – residential, farmland, and multi-family           | 10,423                 | 12,109                         | —                    | 9,723                             |
| Real estate – home equity lines of credit                       | —                      | —                              | —                    | 95                                |
| Real estate – commercial  | 9,992                  | 11,022                         | —                    | 14,585                            |
| Consumer  | —                      | —                              | —                    | 1                                 |
| Total non-covered impaired loans with no allowance              | \$ 24,699              | 30,955                         | —                    | 29,159                            |
| Total covered impaired loans with no allowance                  | \$ 5,231               | 8,529                          | —                    | 5,607                             |
| Total impaired loans with no allowance recorded                 | \$ 29,930              | 39,484                         | —                    | 34,766                            |
| Non-covered loans with an allowance recorded:                   |                        |                                |                      |                                   |
| Commercial, financial, and agricultural:                        |                        |                                |                      |                                   |
| Commercial - unsecured  | \$ 129                 | 140                            | 77                   | 137                               |
| Commercial - secured  | 416                    | 443                            | 113                  | 513                               |
| Secured by inventory and accounts receivable                    | —                      | —                              | —                    | —                                 |
| Real estate – construction, land development & other land loans | 632                    | 640                            | 213                  | 1,217                             |
| Real estate – residential, farmland, and multi-family           | 13,416                 | 13,586                         | 1,478                | 14,039                            |
| Real estate – home equity lines of credit                       | 376                    | 376                            | 313                  | 75                                |
| Real estate – commercial  | 5,407                  | 5,592                          | 333                  | 3,968                             |
| Consumer  | 160                    | 160                            | 160                  | 32                                |
| Total non-covered impaired loans with allowance                 | \$ 20,536              | 20,937                         | 2,687                | 19,981                            |
| Total covered impaired loans with allowance                     | \$ 3,213               | 3,476                          | 624                  | 3,742                             |

|   |           |        |       |        |
|---|-----------|--------|-------|--------|
| Total impaired loans with an allowance recorded | \$ 23,749 | 24,413 | 3,311 | 23,723 |
|---|-----------|--------|-------|--------|

Interest income recorded on non-covered and covered impaired loans during the year ended December 31, 2015 was insignificant.

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The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2014.

| <i>(\$ in thousands)</i>  | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment |
|---|------------------------|--------------------------------|----------------------|-----------------------------------|
| Non-covered loans with no related allowance recorded:           |                        |                                |                      |                                   |
| Commercial, financial, and agricultural:                        |                        |                                |                      |                                   |
| Commercial - unsecured  | \$ 33                  | 35                             | —                    | 20                                |
| Commercial - secured  | 5                      | 6                              | —                    | 95                                |
| Secured by inventory and accounts receivable                    | —                      | —                              | —                    | —                                 |
| Real estate – construction, land development & other land loans | 6,877                  | 7,944                          | —                    | 6,430                             |
| Real estate – residential, farmland, and multi-family           | 9,165                  | 10,225                         | —                    | 7,776                             |
| Real estate – home equity lines of credit                       | 476                    | 498                            | —                    | 388                               |
| Real estate – commercial  | 17,409                 | 20,786                         | —                    | 11,911                            |
| Consumer  | 7                      | 10                             | —                    | 7                                 |
| Total non-covered impaired loans with no allowance              | \$ 33,972              | 39,504                         | —                    | 26,627                            |
| Total covered impaired loans with no allowance                  | \$ 8,097               | 12,081                         | —                    | 16,986                            |
| Total impaired loans with no allowance recorded                 | \$ 42,069              | 51,585                         | —                    | 43,613                            |
| Non-covered loans with an allowance recorded:                   |                        |                                |                      |                                   |
| Commercial, financial, and agricultural:                        |                        |                                |                      |                                   |
| Commercial - unsecured  | \$ 140                 | 143                            | 47                   | 142                               |
| Commercial - secured  | 606                    | 612                            | 164                  | 550                               |
| Secured by inventory and accounts receivable                    | —                      | —                              | —                    | 15                                |
| Real estate – construction, land development & other land loans | 1,114                  | 3,243                          | 415                  | 1,487                             |
| Real estate – residential, farmland, and multi-family           | 14,845                 | 15,257                         | 1,686                | 14,418                            |
| Real estate – home equity lines of credit                       | —                      | —                              | —                    | 4                                 |
| Real estate – commercial  | 3,501                  | 3,530                          | 165                  | 6,420                             |
| Consumer  | —                      | —                              | —                    | 8                                 |
| Total non-covered impaired loans with allowance                 | \$ 20,206              | 22,785                         | 2,477                | 23,044                            |
| Total covered impaired loans with allowance                     | \$ 5,220               | 5,719                          | 1,229                | 8,513                             |
| Total impaired loans with an allowance recorded                 | \$ 25,426              | 28,504                         | 3,706                | 31,557                            |

Interest income recorded on non-covered and covered impaired loans during the year ended December 31, 2014 was insignificant.

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The Company tracks credit quality based on its internal risk ratings. Upon origination a loan is assigned an initial risk grade, which is generally based on several factors such as the borrower’s credit score, the loan-to-value ratio, the debt-to-income ratio, etc. Loans that are risk-graded as substandard during the origination process are declined. After loans are initially graded, they are monitored monthly for credit quality based on many factors, such as payment history, the borrower’s financial status, and changes in collateral value. Loans can be downgraded or upgraded depending on management’s evaluation of these factors. Internal risk-grading policies are consistent throughout each loan type.

The following describes the Company’s internal risk grades in ascending order of likelihood of loss:

| Numerical Risk Grade      | Description   |
|---------------------------|---|
| <u>Pass:</u>              |   |
| 1                         | Loans with virtually no risk, including cash secured loans.   |
| 2                         | Loans with documented significant overall financial strength. These loans have minimum chance of loss due to the presence of multiple sources of repayment – each clearly sufficient to satisfy the obligation.   |
| 3                         | Loans with documented satisfactory overall financial strength. These loans have a low loss potential due to presence of at least two clearly identified sources of repayment – each of which is sufficient to satisfy the obligation under the present circumstances. |
| 4                         | Loans to borrowers with acceptable financial condition. These loans could have signs of minor operational weaknesses, lack of adequate financial information, or loans supported by collateral with questionable value or marketability.                              |
| <u>Watch or Standard:</u> |   |
| 9                         | Existing loans that meet the guidelines for a Risk Graded 5 loan, except the collateral coverage is sufficient to satisfy the debt with no risk of loss under reasonable circumstances.   |
| <u>Special Mention:</u>   |   |
| 5                         | Existing loans with defined weaknesses in primary source of repayment that, if not corrected, could cause a loss to the Bank.   |
| <u>Classified:</u>        |   |
| 6                         | An existing loan inadequately protected by the current sound net worth and paying capacity of the obligor or the collateral pledged, if any. These loans have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt.                      |
| 7                         | Loans that have a well-defined weakness that make the collection or liquidation in full highly questionable and improbable. Loss appears imminent, but the exact amount and timing is uncertain.  |
| 8                         | Loans that are considered uncollectible and are in the process of being charged-off. This grade is a temporary grade assigned for administrative purposes until the charge-off is completed.  |

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The following table presents the Company's recorded investment in loans by credit quality indicators as of December 31, 2015.

| (\$ in thousands)   | Credit Quality Indicator (Grouped by Internally Assigned Grades) |   |  |   |   |                      |
|---|--|---|--|---|---|----------------------|
|   | Pass<br>(Grades<br>1, 2, & 3)                                    | Pass –<br>Acceptable/<br>Average<br>(Grade 4) | Watch<br>or<br>Standard<br>Loans<br>(Grade<br>9) | Special<br>Mention<br>Loans<br>(Grade<br>5) | Classified<br>Loans<br>(Grades<br>6, 7, &<br>8) | Nonaccruing<br>Loans |
| Non-covered loans:  |  |   |  |   |   |                      |
| Commercial, financial, and agricultural:                        |  |   |  |   |   |                      |
| Commercial - unsecured  | \$26,978   | 22,276  | —  | 1,196                                       | 1,060   | 391                  |
| Commercial - secured  | 56,428   | 51,464  | 32   | 2,478                                       | 1,872   | 2,406                |
| Secured by inventory and accounts receivable                    | 18,955   | 19,120  | —  | 252   | 576   | 83                   |
| Real estate – construction, land development & other land loans | 106,881  | 158,563                                       | 578  | 11,545                                      | 8,656   | 4,155                |
| Real estate – residential, farmland, and multi-family           | 216,549  | 532,859                                       | 4,083  | 43,654                                      | 32,634  | 21,964               |
| Real estate – home equity lines of credit                       | 135,828  | 62,638  | 1,544  | 5,232                                       | 3,772   | 2,431                |
| Real estate - commercial  | 292,433  | 464,824                                       | 7,605  | 26,339                                      | 12,917  | 8,262                |
| Consumer  | 29,617   | 13,194  | 51   | 303   | 432   | 302                  |
| Total   | \$883,669  | 1,324,938                                     | 13,893   | 90,999                                      | 61,919  | 39,994               |
| Unamortized net deferred loan costs                             |  |   |  |   |   |                      |
| Total non-covered loans   |  |   |  |   |   |                      |
| Total covered loans   | \$11,537   | 59,611  | 250  | 7,423                                       | 16,004  | 7,816                |
| Total loans   | \$895,206  | 1,384,549                                     | 14,143   | 98,422                                      | 77,923  | 47,810               |

At December 31, 2015, there was an insignificant amount of loans that were graded “8” with an accruing status.

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The following table presents the Company's recorded investment in loans by credit quality indicators as of December 31, 2014.

| (\$ in thousands)   | Credit Quality Indicator (Grouped by Internally Assigned Grades) |   |  |   |   |                     |
|---|--|---|--|---|---|---------------------|
|   | Pass<br>(Grades<br>1, 2, & 3)                                    | Pass –<br>Acceptable/<br>Average<br>(Grade 4) | Watch<br>or<br>Standard<br>Loans<br>(Grade<br>9) | Special<br>Mention<br>Loans<br>(Grade<br>5) | Classified<br>Loans<br>(Grades<br>6, 7, &<br>8) | Nonaccrual<br>Loans |
| Non-covered loans:  |  |   |  |   |   |                     |
| Commercial, financial, and agricultural:                        |  |   |  |   |   |                     |
| Commercial - unsecured  | \$17,856   | 15,649  | 5  | 1,356                                       | 2,231   | 187                 |
| Commercial - secured  | 32,812   | 62,361  | 62   | 4,481                                       | 4,331   | 2,927               |
| Secured by inventory and accounts receivable                    | 10,815   | 9,928   | —  | 767   | 506   | 454                 |
| Real estate – construction, land development & other land loans | 87,806   | 135,072                                       | 771  | 13,066                                      | 12,909  | 7,891               |
| Real estate – residential, farmland, and multi-family           | 221,581  | 520,790                                       | 4,536  | 40,993                                      | 34,474  | 24,451              |
| Real estate – home equity lines of credit                       | 122,528  | 62,642  | 1,135  | 5,166                                       | 4,533   | 2,573               |
| Real estate - commercial  | 223,197  | 465,395                                       | 9,057  | 30,318                                      | 15,748  | 11,071              |
| Consumer  | 25,520   | 15,614  | 54   | 855   | 648   | 505                 |
| Total   | \$742,115  | 1,287,451                                     | 15,620   | 97,002                                      | 75,380  | 50,061              |
| Unamortized net deferred loan costs                             |  |   |  |   |   |                     |
| Total non-covered loans   |  |   |  |   |   |                     |
| Total covered loans   | \$14,349   | 70,989  | 632  | 10,503                                      | 20,613  | 10,500              |
| Total loans   | \$756,464  | 1,358,440                                     | 16,252   | 107,505                                     | 95,993  | 60,571              |

At December 31, 2014, there was an insignificant amount of loans that were graded “8” with an accruing status.

As previously discussed, on July 1, 2014, the Company transferred \$39.7 million of loans from the covered category to the non-covered category as a result of the scheduled expiration of one of the Company's loss-share agreements with the FDIC. Approximately \$2.8 million of those loans were “Special Mention Loans”, \$5.5 million were “Classified Loans”, and \$9.7 million were “Nonaccrual Loans.”

*Troubled Debt Restructurings*

The restructuring of a loan is considered a “troubled debt restructuring” if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules and other actions intended to minimize potential losses.

The vast majority of the Company’s troubled debt restructurings modified during the year ended December 31, 2015 and 2014 related to interest rate reductions combined with restructured amortization schedules. The Company does not generally grant principal forgiveness.

All loans classified as troubled debt restructurings are considered to be impaired and are evaluated as such for determination of the allowance for loan losses. The Company’s troubled debt restructurings can be classified as either nonaccrual or accruing based on the loan’s payment status. The troubled debt restructurings that are nonaccrual are reported within the nonaccrual loan totals presented previously.

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The following table presents information related to loans modified in a troubled debt restructuring during the years ended December 31, 2015 and 2014.

| (\$ in thousands)   | For the year ended<br>December 31, 2015 |  |   | For the year ended<br>December 31, 2014 |  |   |
|---|---|--|---|---|--|---|
|   | Number<br>of<br>Contracts               | Pre-<br>Modification<br>of<br>Restructured<br>Balances | Post-<br>Modification<br>of<br>Restructured<br>Balances | Number<br>of<br>Contracts               | Pre-<br>Modification<br>of<br>Restructured<br>Balances | Post-<br>Modification<br>of<br>Restructured<br>Balances |
| Non-covered TDRs – Accruing                                     |   |  |   |   |  |   |
| Commercial, financial, and agricultural:                        |   |  |   |   |  |   |
| Commercial – unsecured  | 1                                       | \$ 8   | \$ 8  | —                                       | \$ —   | \$ —  |
| Commercial – secured  | —                                       | —  | —   | —                                       | —  | —   |
| Secured by inventory and accounts receivable                    | —                                       | —  | —   | —                                       | —  | —   |
| Real estate – construction, land development & other land loans | 1                                       | 235  | 235   | —                                       | —  | —   |
| Real estate – residential, farmland, and multi-family           | 3                                       | 286  | 286   | 11                                      | 2,571  | 2,571   |
| Real estate – home equity lines of credit                       | —                                       | —  | —   | —                                       | —  | —   |
| Real estate – commercial  | 2                                       | 441  | 441   | 2                                       | 2,416  | 2,415   |
| Consumer  | —                                       | —  | —   | —                                       | —  | —   |
| Non-covered TDRs – Nonaccrual                                   |   |  |   |   |  |   |
| Commercial, financial, and agricultural:                        |   |  |   |   |  |   |
| Commercial – unsecured  | —                                       | —  | —   | —                                       | —  | —   |
| Commercial – secured  | 1                                       | 5  | 5   | 1                                       | 15   | 15  |
| Secured by inventory and accounts receivable                    | —                                       | —  | —   | —                                       | —  | —   |
| Real estate – construction, land development & other land loans | 2                                       | 495  | 495   | —                                       | —  | —   |
| Real estate – residential, farmland, and multi-family           | 5                                       | 400  | 400   | 8                                       | 770  | 769   |
| Real estate – home equity lines of credit                       | —                                       | —  | —   | —                                       | —  | —   |
| Real estate – commercial  | —                                       | —  | —   | 2                                       | 98   | 98  |
| Consumer  | —                                       | —  | —   | —                                       | —  | —   |
| Total non-covered TDRs arising during period                    | 15                                      | 1,870  | 1,870   | 24                                      | 5,870  | 5,868   |
| Total covered TDRs arising during period– Accruing              |   |  |   |   |  |   |
| Total covered TDRs arising during period – Nonaccrual           | —                                       | —  | —   | 8                                       | 966  | 933   |
| Total TDRs arising during period                                | 17                                      | \$ 2,009   | \$ 2,009  | 37                                      | \$ 7,780   | \$ 7,728  |

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Accruing restructured loans that were modified in the previous 12 months and that defaulted during the years ended December 31, 2015 and 2014 are presented in the table below. The Company considers a loan to have defaulted when it becomes 90 or more days delinquent under the modified terms, has been transferred to nonaccrual status, or has been transferred to foreclosed real estate.

| (\$ in thousands)   | For the year ended<br>December 31, 2015 |                        | For the year ended<br>December 31, 2014 |                        |
|---|---|------------------------|---|------------------------|
|   | Number<br>of<br>Contracts               | Recorded<br>Investment | Number<br>of<br>Contracts               | Recorded<br>Investment |
| Non-covered accruing TDRs that subsequently defaulted<br>Commercial, financial, and agricultural: |   |                        |   |                        |
| Commercial – unsecured  | 1                                       | \$ 7                   | —                                       | \$ —                   |
| Real estate – construction, land development & other land loans                                   | —                                       | —                      | 1                                       | 5                      |
| Real estate – residential, farmland, and multi-family   | 4                                       | 352                    | —                                       | —                      |
| Real estate – commercial  | —                                       | —                      | 1                                       | 71                     |
| Total non-covered TDRs that subsequently defaulted  | 5                                       | \$ 359                 | 2                                       | \$ 76                  |
| Total accruing covered TDRs that subsequently defaulted   | —                                       | \$ —                   | 1                                       | \$ 353                 |
| Total accruing TDRs that subsequently defaulted   | 5                                       | \$ 359                 | 3                                       | \$ 429                 |

**Note 5. Premises and Equipment**

Premises and equipment at December 31, 2015 and 2014 consisted of the following:

| (\$ in thousands)                              | 2015      | 2014      |
|--|-----------|-----------|
| Land   | \$23,750  | 23,911    |
| Buildings                                      | 66,527    | 65,130    |
| Furniture and equipment                        | 36,246    | 35,423    |
| Leasehold improvements                         | 1,704     | 1,323     |
| Total cost                                     | 128,227   | 125,787   |
| Less accumulated depreciation and amortization | (53,668 ) | (50,674 ) |
| Net book value of premises and equipment       | \$74,559  | 75,113    |

**Note 6. FDIC Indemnification Asset**

As discussed in Note 1(i), the FDIC indemnification asset is the estimated amount that the Company will receive from the FDIC under loss share agreements associated with two FDIC-assisted failed bank acquisitions. See unaudited additional information regarding the FDIC indemnification asset in the “FDIC Indemnification Asset” section of the Management’s Discussion and Analysis included in the Company’s Form 10-K.

At December 31, 2015 and 2014, the FDIC indemnification asset was comprised of the following components:

| (\$ in thousands)   | 2015     | 2014   |
|---|----------|--------|
| Receivable (payable) related to loss claims incurred (recoveries), not yet received (paid), net | \$(633 ) | 6,899  |
| Receivable related to estimated future claims on loans  | 8,675    | 14,933 |
| Receivable related to estimated future claims on foreclosed real estate                         | 397      | 737    |
| FDIC indemnification asset  | \$8,439  | 22,569 |

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Included in the receivable related to loss claims incurred, not yet reimbursed, at December 31, 2014, was \$1.2 million related to two claims involving the same borrower. The FDIC initially denied both claims because the FDIC disagreed with the collection strategy that the Company undertook. During the second quarter of 2015, the Company and the FDIC reached an agreement to resolve this matter, as follows. One of the two claims amounting to \$324,000 was accepted by the FDIC and the related loan remains subject to the loss share agreement, which provides that any future recoveries realized prior to June 30, 2017 are to be split on an 80%/20% basis with the FDIC (the FDIC receives 80%). For the other claim amounting to \$886,000, the FDIC paid the Company \$480,000 and the related loan was removed from the provisions of the loss share agreement. This will result in the Company retaining 100% of any future recoveries. As a result of this negotiated agreement, during the second quarter of 2015, the Company wrote off the \$406,000 portion of the claim not being reimbursed by the FDIC, which is reflected in the “Other gains (losses)” line item in the Consolidated Statements of Income.

The following presents a rollforward of the FDIC indemnification asset since January 1, 2013.

|  |            |
|--|------------|
| (\$ in thousands)  |            |
| Balance at January 1, 2013   | \$ 102,559 |
| Increase (decrease) related to unfavorable (favorable) changes in loss estimates | 9,312      |
| Increase related to reimbursable expenses  | 5,352      |
| Cash received  | (49,572 )  |
| Decrease related to accretion of loan discount                                   | (16,160 )  |
| Other  | (2,869 )   |
| Balance at December 31, 2013   | \$ 48,622  |
| Increase (decrease) related to unfavorable (favorable) changes in loss estimates | 2,923      |
| Increase related to reimbursable expenses  | 3,925      |
| Cash received  | (17,724 )  |
| Decrease related to accretion of loan discount                                   | (15,281 )  |
| Other  | 104        |
| Balance at December 31, 2014   | \$ 22,569  |
| Increase (decrease) related to unfavorable (favorable) changes in loss estimates | (3,031 )   |
| Increase related to reimbursable expenses  | 1,232      |
| Cash received  | (6,673 )   |
| Decrease related to accretion of loan discount                                   | (5,584 )   |
| Decrease related to settlement of disputed claims                                | (406 )     |
| Other  | 332        |
| Balance at December 31, 2015   | \$ 8,439   |

**Note 7. Goodwill and Other Intangible Assets**

The following is a summary of the gross carrying amount and accumulated amortization of amortized intangible assets as of December 31, 2015 and December 31, 2014 and the carrying amount of unamortized intangible assets as of those



same dates.

| (\$ in thousands)              | December 31, 2015     |                          | December 31, 2014     |                          |
|--------------------------------|-----------------------|--------------------------|-----------------------|--------------------------|
|                                | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Amortized intangible assets:   |                       |                          |                       |                          |
| Customer lists                 | \$ 678                | 550                      | 678                   | 505                      |
| Core deposit premiums          | 8,560                 | 7,352                    | 8,560                 | 6,675                    |
| Total                          | \$ 9,238              | 7,902                    | 9,238                 | 7,180                    |
| Unamortized intangible assets: |                       |                          |                       |                          |
| Goodwill                       | \$ 65,835             |                          | 65,835                |                          |

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Amortization expense totaled \$722,000, \$777,000 and \$860,000 for the years ended December 31, 2015, 2014 and 2013, respectively.

Goodwill is evaluated for impairment on at least an annual basis – see Note 1(q). For each of the years presented, the Company's evaluation indicated that there was no goodwill impairment.

The following table presents the estimated amortization expense for intangible assets for each of the five calendar years ending December 31, 2020 and the estimated amount amortizable thereafter. These estimates are subject to change in future periods to the extent management determines it is necessary to make adjustments to the carrying value or estimated useful lives of amortized intangible assets.

| <i>(\$ in thousands)</i> | Estimated<br>Amortization Expense |
|--------------------------|-----------------------------------|
| 2016                     | \$ 654                            |
| 2017                     | 404                               |
| 2018                     | 129                               |
| 2019                     | 122                               |
| 2020                     | 27                                |
| Thereafter               | —                                 |
| Total                    | \$ 1,336                          |

**Note 8. Income Taxes**

Total income taxes for the years ended December 31, 2015, 2014 and 2013 were allocated as follows:

| (\$ in thousands)  | 2015     | 2014     | 2013     |
|--|----------|----------|----------|
| Allocated to net income  | \$14,126 | 13,535   | 12,081   |
| Allocated to stockholders' equity, for unrealized holding gain/loss on debt and equity securities for financial reporting purposes | (184 )   | 518      | (2,072 ) |
| Allocated to stockholders' equity, for tax benefit of pension liabilities  | (1,716 ) | (2,103 ) | 3,399    |
| Total income taxes   | \$12,226 | 11,950   | 13,408   |

The components of income tax expense (benefit) for the years ended December 31, 2015, 2014 and 2013 are as follows:

| (\$ in thousands)  | 2015     | 2014   | 2013   |
|--------------------|----------|--------|--------|
| Current - Federal  | \$9,149  | 1,316  | 9,812  |
| - State            | 1,436    | 903    | (467 ) |
| Deferred - Federal | 3,205    | 10,104 | 168    |
| - State            | 336      | 1,212  | 2,568  |
| Total              | \$14,126 | 13,535 | 12,081 |

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The sources and tax effects of temporary differences that give rise to significant portions of the deferred tax assets (liabilities) at December 31, 2015 and 2014 are presented below:

| (\$ in thousands)   | 2015     | 2014     |
|---|----------|----------|
| Deferred tax assets:  |          |          |
| Allowance for loan losses                                     | \$10,020 | 14,558   |
| Excess book over tax SERP retirement plan cost                | 2,528    | 2,566    |
| Deferred compensation   | 50       | 78       |
| Federal & state net operating loss carryforwards              | 58       | 1,066    |
| Accruals, book versus tax                                     | 2,130    | 1,779    |
| Pension liability adjustments                                 | 1,816    | 100      |
| Foreclosed real estate  | 571      | 1,222    |
| Basis differences in assets acquired in FDIC transactions     | 1,384    | —        |
| Nonqualified stock options                                    | 554      | 521      |
| Partnership investments                                       | 164      | 219      |
| Unrealized gain on securities available for sale              | 453      | 270      |
| All other   | 200      | 212      |
| Gross deferred tax assets                                     | 19,928   | 22,591   |
| Less: Valuation allowance                                     | (67 )    | (125 )   |
| Net deferred tax assets                                       | 19,861   | 22,466   |
| Deferred tax liabilities:                                     |          |          |
| Loan fees   | (1,451 ) | (1,413 ) |
| Excess tax over book pension cost                             | (1,857 ) | (1,316 ) |
| Depreciable basis of fixed assets                             | (1,313 ) | (1,197 ) |
| Amortizable basis of intangible assets                        | (11,263) | (10,582) |
| FHLB stock dividends  | (416 )   | (422 )   |
| Basis differences in assets acquired in FDIC transactions     | —        | (2,322 ) |
| All other   | (12 )    | (23 )    |
| Gross deferred tax liabilities                                | (16,312) | (17,275) |
| Net deferred tax asset (liability) - included in other assets | \$3,549  | 5,191    |

A portion of the annual change in the net deferred tax asset relates to unrealized gains and losses on securities available for sale. The related 2015 and 2014 deferred tax expense (benefit) of approximately (\$184,000) and \$518,000 respectively, has been recorded directly to shareholders' equity. Additionally, a portion of the annual change in the net deferred tax asset relates to pension adjustments. The related 2015 and 2014 deferred tax expense (benefit) of (\$1,716,000) and (\$2,103,000) respectively, has been recorded directly to shareholders' equity. The balance of the 2015 decrease in the net deferred tax asset of \$3,541,000 is reflected as a deferred income tax expense, and the balance of the 2014 decrease in the net deferred tax asset of \$11,316,000 is reflected as a deferred income tax expense in the consolidated statement of income.

The valuation allowances for 2015 and 2014 relate primarily to state net operating loss carryforwards. It is management's belief that the realization of the remaining net deferred tax assets is more likely than not. The Company adjusted its net deferred income tax asset as a result of reductions in the North Carolina income tax rate, which reduced the state income tax rate to 4% effective January 1, 2016.

The Company had no significant uncertain tax positions, and thus no reserve for uncertain tax positions has been recorded. Additionally, the Company determined that it has no material unrecognized tax benefits that if recognized would affect the effective tax rate. The Company's general policy is to record tax penalties and interest as a component of "other operating expenses".

The Company is subject to routine audits of its tax returns by the Internal Revenue Service and various state taxing authorities. The Company's federal tax returns through the year 2013 were audited during the year. The Company's state tax returns are subject to income tax audit by state agencies beginning with the year 2012. There are no indications of any material adjustments relating to any examination currently being conducted by any taxing authority.

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Retained earnings at December 31, 2015 and 2014 includes approximately \$6,869,000 representing pre-1988 tax bad debt reserve base year amounts for which no deferred income tax liability has been provided since these reserves are not expected to reverse or may never reverse. Circumstances that would require an accrual of a portion or all of this unrecorded tax liability are a reduction in qualifying loan levels relative to the end of 1987, failure to meet the definition of a bank, dividend payments in excess of accumulated tax earnings and profits, or other distributions in dissolution, liquidation or redemption of the Bank's stock.

The following is a reconciliation of federal income tax expense at the statutory rate of 35% to the income tax provision reported in the financial statements.

| (\$ in thousands)                                   | 2015      | 2014   | 2013   |
|---|-----------|--------|--------|
| Tax provision at statutory rate                     | \$ 14,405 | 13,486 | 11,473 |
| Increase (decrease) in income taxes resulting from: |           |        |        |
| Tax-exempt interest income                          | (930 )    | (832 ) | (818 ) |
| Low income housing tax credits                      | (191 )    | (179 ) | (150 ) |
| Non-deductible interest expense                     | 11        | 11     | 15     |
| State income taxes, net of federal benefit          | 1,152     | 1,375  | 1,366  |
| Change in valuation allowance                       | (58 )     | 16     | (3 )   |
| Other, net  | (263 )    | (342 ) | 198    |
| Total   | \$ 14,126 | 13,535 | 12,081 |

**Note 9. Time Deposits and Related Party Deposits**

At December 31, 2015, the scheduled maturities of time deposits were as follows:

| (\$ in thousands) |           |
|-------------------|-----------|
| 2016              | \$569,562 |
| 2017              | 65,143    |
| 2018              | 25,604    |
| 2019              | 10,840    |
| 2020              | 24,080    |
| Thereafter        | 4,335     |
|                   | \$699,564 |

Deposits received from executive officers and directors and their associates totaled approximately \$1,982,000 and \$25,388,000 at December 31, 2015 and 2014, respectively. These deposit accounts have substantially the same terms, including interest rates, as those prevailing at the time for comparable transactions with other non-related depositors.

As of December 31, 2015 and 2014, the Company held \$226.0 million and \$256.7 million, respectively, in time deposits of \$250,000 or more (which is the current FDIC insurance limit for insured deposits as of December 31, 2015). Included in these deposits were brokered deposits of \$71.8 million and \$82.8 million at December 31, 2015 and 2014, respectively.

Table of Contents**Note 10. Borrowings and Borrowings Availability**

The following tables present information regarding the Company's outstanding borrowings at December 31, 2015 and 2014:

| Description - 2015   | Due date | Call Feature                              | 2015<br>Amount | Interest Rate   |
|--|----------|---|----------------|---|
| FHLB Term Note   | 1/19/16  | None                                      | \$30,000,000   | 0.41% fixed   |
| FHLB Term Note   | 1/29/16  | None                                      | 50,000,000     | 0.38% fixed   |
| FHLB Term Note   | 12/27/16 | None                                      | 20,000,000     | 0.76% fixed   |
| FHLB Term Note   | 12/26/17 | None                                      | 20,000,000     | 1.19% fixed   |
| FHLB Term Note   | 12/24/18 | None                                      | 20,000,000     | 1.57% fixed   |
| Trust Preferred Securities                                       | 1/23/34  | Quarterly by Company<br>beginning 1/23/09 | 20,620,000     | 3.02% at 12/31/15<br>adjustable rate<br>3 month LIBOR + 2.70% |
| Trust Preferred Securities                                       | 6/15/36  | Quarterly by Company<br>beginning 6/15/11 | 25,774,000     | 1.90% at 12/31/15<br>adjustable rate<br>3 month LIBOR + 1.39% |
| Total borrowings / weighted average rate as of December 31, 2015 |          |   | \$186,394,000  | 1.14%   |
| Description - 2014   | Due date | Call Feature                              | 2014<br>Amount | Interest Rate   |
| FHLB Term Note   | 1/29/15  | None                                      | \$50,000,000   | 0.20% fixed   |
| FHLB Term Note   | 9/30/15  | None                                      | 20,000,000     | 0.44% fixed   |
| Trust Preferred Securities                                       | 1/23/34  | Quarterly by Company<br>beginning 1/23/09 | 20,620,000     | 2.96% at 12/31/14<br>adjustable rate<br>3 month LIBOR + 2.70% |
| Trust Preferred Securities                                       | 6/15/36  | Quarterly by Company<br>beginning 6/15/11 | 25,774,000     | 1.65% at 12/31/14<br>adjustable rate<br>3 month LIBOR + 1.39% |
| Total borrowings / weighted average rate as of December 31, 2014 |          |   | \$116,394,000  | 1.05%   |

All outstanding FHLB borrowings may be accelerated immediately by the FHLB in certain circumstances, including material adverse changes in the condition of the Company or if the Company's qualifying collateral amounts to less than that required under the terms of the FHLB borrowing agreement.



In the above tables, the \$20.6 million in borrowings due on January 23, 2034 relate to borrowings structured as trust preferred capital securities that were issued by First Bancorp Capital Trusts II and III (\$10.3 million by each trust), which are unconsolidated subsidiaries of the Company, on December 19, 2003 and qualify as capital for regulatory capital adequacy requirements. These unsecured debt securities are callable by the Company at par on any quarterly interest payment date beginning on January 23, 2009. The interest rate on these debt securities adjusts on a quarterly basis at a rate of three-month LIBOR plus 2.70%.

In the above tables, the \$25.8 million in borrowings due on June 15, 2036 relate to borrowings structured as trust preferred capital securities that were issued by First Bancorp Capital Trust IV, an unconsolidated subsidiary of the Company, on April 13, 2006 and qualify as capital for regulatory capital adequacy requirements. These unsecured debt securities are callable by the Company at par on any quarterly interest payment date beginning on June 15, 2011. The interest rate on these debt securities adjusts on a quarterly basis at a rate of three-month LIBOR plus 1.39%.

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At December 31, 2015, the Company had four sources of readily available borrowing capacity – 1) an approximately \$589 million line of credit with the FHLB, of which \$140 million was outstanding at December 31, 2015 and \$70 million was outstanding at December 31, 2014, 2) a \$50 million overnight federal funds line of credit with a correspondent bank, of which none was outstanding at December 31, 2015 or 2014, 3) a \$35 million federal funds line of credit with a correspondent bank, of which none was outstanding at December 31, 2015 or 2014, and 4) an approximately \$88 million line of credit through the Federal Reserve Bank of Richmond's (FRB) discount window, of which none was outstanding at December 31, 2015 or 2014.

The Company's line of credit with the FHLB totaling approximately \$589 million can be structured as either short-term or long-term borrowings, depending on the particular funding or liquidity needs and is secured by the Company's FHLB stock and a blanket lien on most of its real estate loan portfolio. The borrowing capacity was reduced by \$193 million at both December 31, 2015 and 2014, as a result of the Company pledging letters of credit for public deposits at each of those dates. Accordingly, the Company's unused FHLB line of credit was \$256 million at December 31, 2015.

The Company's two correspondent bank relationships allows the Company to purchase up to \$50 million and \$35 million in federal funds on an overnight, unsecured basis (federal funds purchased). The Company had no borrowings outstanding under these lines at December 31, 2015 or 2014.

The Company has a line of credit with the FRB discount window. This line is secured by a blanket lien on a portion of the Company's commercial and consumer loan portfolio (excluding real estate). Based on the collateral owned by the Company as of December 31, 2015, the available line of credit was approximately \$88 million. The Company had no borrowings outstanding under this line of credit at December 31, 2015 or 2014.

**Note 11. Leases**

Certain bank premises are leased under operating lease agreements. Generally, operating leases contain renewal options on substantially the same basis as current rental terms. Rent expense charged to operations under all operating lease agreements was \$1.2 million in 2015, \$1.2 million in 2014, and \$1.1 million in 2013.

Future obligations for minimum rentals under noncancelable operating leases at December 31, 2015 are as follows:

(\$ in thousands)

Year ending December 31:

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|            |         |
|------------|---------|
| 2016       | \$1,122 |
| 2017       | 1,008   |
| 2018       | 838     |
| 2019       | 610     |
| 2020       | 412     |
| Thereafter | 677     |
| Total      | \$4,667 |

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**Note 12. Employee Benefit Plans**

**401(k) Plan.** The Company sponsors a retirement savings plan pursuant to Section 401(k) of the Internal Revenue Code. New employees who have met the age requirement are automatically enrolled in the plan at a 5% deferral rate on the next plan Entry Date. The automatic deferral can be modified by the employee at any time. An eligible employee may contribute up to 15% of annual salary to the plan. The Company contributes an amount equal to the sum of 1) 100% of the employee's salary contributed up to 3% and 2) 50% of the employee's salary contributed between 3% and 5%. Company contributions are 100% vested immediately. The Company's matching contribution expense was \$1.4 million for each of the years ended December 31, 2015, 2014, and 2013. Although discretionary contributions by the Company are permitted by the plan, the Company did not make any such contributions in 2015, 2014 or 2013. The Company's matching and discretionary contributions are made according to the same investment elections each participant has established for their deferral contributions.

**Pension Plan.** Historically, the Company offered a noncontributory defined benefit retirement plan (the "Pension Plan") that qualified under Section 401(a) of the Internal Revenue Code. The Pension Plan provided for a monthly payment, at normal retirement age of 65, equal to one-twelfth of the sum of (i) 0.75% of Final Average Annual Compensation (5 highest consecutive calendar years' earnings out of the last 10 years of employment) multiplied by the employee's years of service not in excess of 40 years, and (ii) 0.65% of Final Average Annual Compensation in excess of the average social security wage base multiplied by years of service not in excess of 35 years. Benefits were fully vested after five years of service. Effective December 31, 2012, the Company froze the Pension Plan for all participants.

The Company's contributions to the Pension Plan are based on computations by independent actuarial consultants and are intended to be deductible for income tax purposes. As discussed below, the contributions are invested to provide for benefits under the Pension Plan. The Company did not make any contributions to the Pension Plan in 2015, 2014 or 2013. The Company does not expect to contribute to the Pension Plan in 2016.

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The following table reconciles the beginning and ending balances of the Pension Plan's benefit obligation, as computed by the Company's independent actuarial consultants, and its plan assets, with the difference between the two amounts representing the funded status of the Pension Plan as of the end of the respective year.

| (\$ in thousands)                       | 2015     | 2014     | 2013     |
|---|----------|----------|----------|
| Change in benefit obligation            |          |          |          |
| Benefit obligation at beginning of year | \$35,615 | 30,548   | 32,272   |
| Service cost                            | —        | —        | —        |
| Interest cost                           | 1,364    | 1,461    | 1,284    |
| Actuarial (gain) loss                   | 1,236    | 5,320    | (2,343 ) |
| Benefits paid                           | (2,051 ) | (1,714 ) | (665 )   |
| Curtailment gain                        | —        | —        | —        |
| Benefit obligation at end of year       | 36,164   | 35,615   | 30,548   |
| Change in plan assets                   |          |          |          |
| Plan assets at beginning of year        | 37,282   | 36,333   | 30,124   |
| Actual return on plan assets            | 258      | 2,663    | 6,874    |
| Employer contributions                  | —        | —        | —        |
| Benefits paid                           | (2,051 ) | (1,714 ) | (665 )   |
| Plan assets at end of year              | 35,489   | 37,282   | 36,333   |
| Funded status at end of year            | \$(675 ) | 1,667    | 5,785    |

The accumulated benefit obligation related to the Pension Plan was \$36,164,000, \$35,615,000, and \$30,548,000 at December 31, 2015, 2014, and 2013, respectively.

The following table presents information regarding the amounts recognized in the consolidated balance sheets at December 31, 2015 and 2014 as it relates to the Pension Plan, excluding the related deferred tax assets.

| (\$ in thousands) | 2015    | 2014  |
|-------------------|---------|-------|
| Other assets      | \$—     | 1,667 |
| Other liabilities | (675)   | —     |
|                   | \$(675) | 1,667 |

The following table presents information regarding the amounts recognized in accumulated other comprehensive income (AOCI) at December 31, 2015 and 2014, as it relates to the Pension Plan.

| (\$ in thousands)                                    | 2015      | 2014    |
|--|-----------|---------|
| Net gain (loss)                                      | \$(5,682) | (1,857) |
| Prior service cost                                   | —         | —       |
| Amount recognized in AOCI before tax effect          | (5,682)   | (1,857) |
| Tax (expense) benefit                                | 2,216     | 724     |
| Net amount recognized as increase (decrease) to AOCI | \$(3,466) | (1,133) |

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The following table reconciles the beginning and ending balances of accumulated other comprehensive income (AOCI) at December 31, 2015 and 2014, as it relates to the Pension Plan:

| (\$ in thousands)   | 2015      | 2014    |
|---|-----------|---------|
| Accumulated other comprehensive loss at beginning of fiscal year  | \$(1,133) | 2,183   |
| Net gain (loss) arising during period                             | (3,825)   | (5,436) |
| Prior service cost  | —         | —       |
| Transition Obligation   | —         | —       |
| Amortization of unrecognized actuarial loss                       | —         | —       |
| Amortization of prior service cost and transition obligation      | —         | —       |
| Tax (expense) benefit of changes during the year, net             | 1,492     | 2,120   |
| Accumulated other comprehensive gain (loss) at end of fiscal year | \$(3,466) | (1,133) |

The following table reconciles the beginning and ending balances of the prepaid pension cost related to the Pension Plan:

| (\$ in thousands)                                   | 2015    | 2014  |
|---|---------|-------|
| Prepaid pension cost as of beginning of fiscal year | \$3,524 | 2,206 |
| Net periodic pension income (cost) for fiscal year  | 1,483   | 1,318 |
| Actual employer contributions                       | —       | —     |
| Prepaid pension asset as of end of fiscal year      | \$5,007 | 3,524 |

Net pension (income) cost for the Pension Plan included the following components for the years ended December 31, 2015, 2014, and 2013:

| (\$ in thousands)                                | 2015      | 2014    | 2013    |
|--|-----------|---------|---------|
| Service cost – benefits earned during the period | \$—       | —       | —       |
| Interest cost on projected benefit obligation    | 1,364     | 1,461   | 1,284   |
| Expected return on plan assets                   | (2,847)   | (2,779) | (2,307) |
| Net amortization and deferral                    | —         | —       | 49      |
| Net periodic pension (income) cost               | \$(1,483) | (1,318) | (974 )  |

The following table is an estimate of the benefits that will be paid in accordance with the Pension Plan during the indicated time periods:

| (\$ in thousands)                   | Estimated<br>benefit<br>payments |
|-------------------------------------|----------------------------------|
| Year ending December 31, 2016       | \$ 1,307                         |
| Year ending December 31, 2017       | 1,392                            |
| Year ending December 31, 2018       | 1,545                            |
| Year ending December 31, 2019       | 1,678                            |
| Year ending December 31, 2020       | 1,737                            |
| Years ending December 31, 2021-2025 | 9,647                            |

For each of the years ended December 31, 2015, 2014, and 2013, the Company used an expected long-term rate-of-return-on-assets assumption of 7.75%. The Company arrived at this rate based primarily on a third-party investment consulting firm's historical analysis of investment returns, which indicated that the mix of the Pension Plan's assets (generally 75% equities and 25% fixed income) can be expected to return approximately 7.75% on a long term basis.

Funds in the Pension Plan are invested in a mix of investment types in accordance with the Pension Plan's investment policy, which is intended to provide an average annual rate of return of 7% to 10%, while maintaining proper diversification. Except for Company stock, all of the Pension Plan's assets are invested in an unaffiliated bank money market account or mutual funds. The investment policy of the Pension Plan does not permit the use of derivatives, except to the extent that derivatives are used by any of the mutual funds invested in by the Pension Plan. The following table presents the targeted mix of the Pension Plan's assets as of December 31, 2015, as set out by the Plan's investment policy:



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| Investment type                   | Targeted %<br>of Total Assets | Acceptable Range %<br>of Total Assets |
|-----------------------------------|-------------------------------|---------------------------------------|
| Fixed income investments          |                               |                                       |
| Cash/money market account         | 2%                            | 1%-5%                                 |
| US government bond fund           | 10%                           | 10%-20%                               |
| US corporate bond fund            | 10%                           | 5%-15%                                |
| US corporate high yield bond fund | 5%                            | 0%-10%                                |
| Equity investments                |                               |                                       |
| Large cap value fund              | 40%                           | 30%-50%                               |
| Mid cap equity fund               | 10%                           | 5%-15%                                |
| Small cap growth fund             | 8%                            | 5%-15%                                |
| Foreign equity fund               | 10%                           | 5%-15%                                |
| Company stock                     | 5%                            | 0%-10%                                |

The Pension Plan's investment strategy contains certain investment objectives and risks for each permitted investment category. To ensure that risk and return characteristics are consistently followed, the Pension Plan's investments are reviewed at least semi-annually and rebalanced within the acceptable range. Performance measurement of the investments employs the use of certain investment category and peer group benchmarks. The investment category benchmarks as of December 31, 2015 are as follows:

| Investment Category               | Investment Category Benchmark               | Range of Acceptable Deviation<br>from Investment Category<br>Benchmark |
|-----------------------------------|---|--|
| Fixed income investments          |   |  |
| Cash/money market account         | US Treasury T-Bill Auction Index            | 0-50 basis points  |
| US government bond fund           | Barclays Intermediate Government Bond Index | 0-200 basis points   |
| US corporate bond fund            | Barclays Aggregate Index                    | 0-200 basis points   |
| US corporate high yield bond fund | Barclays High Yield Index                   | 0-200 basis points   |
| Equity investments                |   |  |
| Large cap value fund              | Russell 1000 Index                          | 0-300 basis points   |
| Mid cap equity fund               | Russell Mid Cap Index                       | 0-300 basis points   |
| Small cap growth fund             | Russell 2000 Growth Index                   | 0-300 basis points   |
| Foreign equity fund               | MSCI EAFE Index                             | 0-300 basis points   |
| Company stock                     | Russell 2000 Index                          | 0-300 basis points   |

Each of the investment fund's average annualized return over a three-year period should be within the range of acceptable deviation from the benchmarked index shown above. In addition to the investment category benchmarks, the Pension Plan also utilizes certain Peer Group benchmarks, based on Morningstar percentile rankings for each investment category. Funds are generally considered to be underperformers if their category ranking is below the 75<sup>th</sup> percentile for the trailing one-year period; the 50<sup>th</sup> percentile for the trailing three-year period; and the 25<sup>th</sup> percentile for the trailing five-year period.

The Pension Plan invests in various investment securities which are exposed to various risks such as interest rate, market, and credit risks. All of these risks are monitored and managed by the Company. No significant concentration of risk exists within the plan assets at December 31, 2015.

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The fair values of the Company's pension plan assets at December 31, 2015, by asset category, are as follows:

(\$ in thousands)

|                                   | Total<br>Fair<br>Value<br>at<br>December<br>31,<br>2015 | Quoted Prices in<br>Active Markets<br>for Identical<br>Assets (Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|-----------------------------------|---|---|---|--|
| Fixed income investments          |   |   |   |  |
| Money market funds                | \$ 155  | —   | 155   | —  |
| US government bond fund           | 3,398   | 3,398   | —   | —  |
| US corporate bond fund            | 3,357   | 3,357   | —   | —  |
| US corporate high yield bond fund | 1,700   | 1,700   | —   | —  |
| Equity investments                |   |   |   |  |
| Large cap value fund              | 14,703  | 14,703  | —   | —  |
| Small cap growth fund             | 2,845   | 2,845   | —   | —  |
| Mid cap equity fund               | 3,541   | 3,541   | —   | —  |
| Foreign equity fund               | 3,544   | 3,544   | —   | —  |
| Company stock                     | 2,246   | 2,246   | —   | —  |
| Total                             | \$35,489  | 35,334  | 155   | —  |

The fair values of the Company's pension plan assets at December 31, 2014, by asset category, are as follows:

(\$ in thousands)

|                                   | Total<br>Fair<br>Value<br>at<br>December<br>31,<br>2014 | Quoted Prices in<br>Active Markets<br>for Identical<br>Assets (Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|-----------------------------------|---|---|---|--|
| Fixed income investments          |   |   |   |  |
| Money market funds                | \$447   | —   | 447   | —  |
| US government bond fund           | 3,385   | 3,385   | —   | —  |
| US corporate bond fund            | 3,377   | 3,377   | —   | —  |
| US corporate high yield bond fund | 1,741   | 1,741   | —   | —  |
| Equity investments                |   |   |   |  |
| Large cap value fund              | 7,669   | 7,669   | —   | —  |

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|                       |          |        |     |   |
|-----------------------|----------|--------|-----|---|
| Large cap growth fund | 7,694    | 7,694  | —   | — |
| Small cap growth fund | 3,162    | 3,162  | —   | — |
| Mid cap growth fund   | 3,983    | 3,983  | —   | — |
| Foreign equity fund   | 3,611    | 3,611  | —   | — |
| Company stock         | 2,213    | 2,213  | —   | — |
| Total                 | \$37,282 | 36,835 | 447 | — |

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2015 and 2014.

Money market fund: Valued at net asset value (“NAV”), which can be validated with a sufficient level of observable activity (i.e. purchases and sales at NAV), and therefore, the funds were classified within Level 2 of the fair value hierarchy.

Mutual funds: Valued at the daily closing price as reported by the fund. Mutual funds held by the Plan are open-end mutual funds that are registered with the Securities and Exchange Commission and are deemed to be actively traded.

Common stock: Valued at the closing price reported on the active market on which the individual securities are traded.

Supplemental Executive Retirement Plan. Historically, the Company sponsored a Supplemental Executive Retirement Plan (the “SERP”) for the benefit of certain senior management executives of the Company. The purpose of the SERP was to provide additional monthly pension benefits to ensure that each such senior management executive would receive lifetime monthly pension benefits equal to 3% of his or her final average compensation multiplied by his or her years of service (maximum of 20 years) to the Company or its subsidiaries, subject to a maximum of 60% of his or her final average compensation. The amount of a participant’s monthly SERP benefit is reduced by (i) the amount payable under the Company’s qualified Pension Plan (described above), and (ii) 50% of the participant’s primary social security benefit. Final average compensation means the average of the 5 highest consecutive calendar years of earnings during the last 10 years of service prior to termination of employment. The SERP is an unfunded plan. Payments are made from the general assets of the Company. Effective December 31, 2012, the Company froze the SERP to all participants.

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The following table reconciles the beginning and ending balances of the SERP's benefit obligation, as computed by the Company's independent actuarial consultants:

| (\$ in thousands)                                 | 2015      | 2014    | 2013    |
|---|-----------|---------|---------|
| Change in benefit obligation                      |           |         |         |
| Projected benefit obligation at beginning of year | \$5,216   | 5,292   | 6,813   |
| Service cost                                      | 201       | 272     | 304     |
| Interest cost                                     | 206       | 212     | 203     |
| Actuarial (gain) loss                             | 497       | (265 )  | (1,856) |
| Benefits paid                                     | (342 )    | (295 )  | (172 )  |
| Curtailment gain                                  | —         | —       | —       |
| Projected benefit obligation at end of year       | 5,778     | 5,216   | 5,292   |
| Plan assets                                       | —         | —       | —       |
| Funded status at end of year                      | \$(5,778) | (5,216) | (5,292) |

The accumulated benefit obligation related to the SERP was \$5,778,000, \$5,216,000, and \$5,292,000 at December 31, 2015, 2014, and 2013, respectively.

The following table presents information regarding the amounts recognized in the consolidated balance sheets at December 31, 2015 and 2014 as it relates to the SERP, excluding the related deferred tax assets.

| (\$ in thousands)                                | 2015      | 2014    |
|--|-----------|---------|
| Other assets – prepaid pension asset (liability) | \$(6,802) | (6,816) |
| Other assets (liabilities)                       | 1,024     | 1,600   |
|  | \$(5,778) | (5,216) |

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The following table presents information regarding the amounts recognized in AOCI at December 31, 2015 and 2014.

| (\$ in thousands)                                    | 2015    | 2014   |
|--|---------|--------|
| Net gain (loss)                                      | \$1,024 | 1,600  |
| Prior service cost                                   | —       | —      |
| Amount recognized in AOCI before tax effect          | 1,024   | 1,600  |
| Tax (expense) benefit                                | (399 )  | (624 ) |
| Net amount recognized as increase (decrease) to AOCI | \$625   | 976    |

The following table reconciles the beginning and ending balances of accumulated other comprehensive income (AOCI) at December 31, 2015 and 2014, as it relates to the SERP:

| (\$ in thousands)   | 2015  | 2014  |
|---|-------|-------|
| Accumulated other comprehensive loss at beginning of fiscal year    | \$976 | 949   |
| Net gain (loss) arising during period                               | (497) | 265   |
| Prior service cost  | —     | —     |
| Amortization of unrecognized actuarial loss                         | (79 ) | (221) |
| Amortization of prior service cost and transition obligation        | —     | —     |
| Tax benefit (expense) related to changes during the year, net       | 225   | (17 ) |
| Accumulated other comprehensive income (loss) at end of fiscal year | \$625 | 976   |

The following table reconciles the beginning and ending balances of the prepaid pension cost related to the SERP:

| (\$ in thousands)   | 2015      | 2014    |
|---|-----------|---------|
| Prepaid pension cost (liability) as of beginning of fiscal year | \$(6,816) | (6,848) |
| Net periodic pension cost for fiscal year                       | (328 )    | (263 )  |
| Benefits paid   | 342       | 295     |
| Prepaid pension cost (liability) as of end of fiscal year       | \$(6,802) | (6,816) |

Net pension cost for the SERP included the following components for the years ended December 31, 2015, 2014, and 2013:

| (\$ in thousands)                                | 2015  | 2014 | 2013 |
|--|-------|------|------|
| Service cost – benefits earned during the period | \$201 | 272  | 304  |

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|   |       |       |       |
|---|-------|-------|-------|
| Interest cost on projected benefit obligation | 206   | 212   | 203   |
| Net amortization and deferral                 | (79)  | (221) | (101) |
| Net periodic pension cost                     | \$328 | 263   | 406   |

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The following table is an estimate of the benefits that will be paid in accordance with the SERP during the indicated time periods:

| <i>(\$ in thousands)</i>            | Estimated<br>benefit<br>payments |
|-------------------------------------|----------------------------------|
| Year ending December 31, 2016       | \$ 376                           |
| Year ending December 31, 2017       | 378                              |
| Year ending December 31, 2018       | 418                              |
| Year ending December 31, 2019       | 415                              |
| Year ending December 31, 2020       | 413                              |
| Years ending December 31, 2021-2025 | 2,095                            |

The following assumptions were used in determining the actuarial information for the Pension Plan and the SERP for the years ended December 31, 2015, 2014, and 2013:

|   | 2015         |       | 2014         |       | 2013         |       |
|---|--------------|-------|--------------|-------|--------------|-------|
|   | Pension Plan | SERP  | Pension Plan | SERP  | Pension Plan | SERP  |
| Discount rate used to determine net periodic pension cost         | 3.82%        | 3.82% | 4.78%        | 4.78% | 3.97%        | 3.97% |
| Discount rate used to calculate end of year liability disclosures | 4.17%        | 4.17% | 3.82%        | 3.82% | 4.78%        | 4.78% |
| Expected long-term rate of return on assets                       | 7.75%        | n/a   | 7.75%        | n/a   | 7.75%        | n/a   |
| Rate of compensation increase                                     | n/a          | n/a   | n/a          | n/a   | n/a          | n/a   |

The Company's discount rate policy is based on a calculation of the Company's expected pension payments, with those payments discounted using the Citigroup Pension Index yield curve.

**Note 13. Commitments, Contingencies, and Concentrations of Credit Risk**

See Note 11 with respect to future obligations under noncancelable operating leases.

In the normal course of the Company's business, there are various outstanding commitments and contingent liabilities such as commitments to extend credit that are not reflected in the financial statements. The following table presents



the Company's outstanding loan commitments at December 31, 2015.

(\$ in millions)

| Type of Commitment  | Fixed<br>Rate | Variable<br>Rate | Total |
|---|---------------|------------------|-------|
| Outstanding closed-end loan commitments   | \$ 81         | 156              | 237   |
| Unfunded commitments on revolving lines of credit, credit cards and home equity loans | 69            | 218              | 287   |
| Total   | \$ 150        | 374              | 524   |

At December 31, 2015 and 2014, the Company had \$13.1 million and \$14.1 million, respectively, in standby letters of credit outstanding. The Company has no carrying amount for these standby letters of credit at either of those dates. The nature of the standby letters of credit is a guarantee made on behalf of the Company's customers to suppliers of the customers to guarantee payments owed to the supplier by the customer. The standby letters of credit are generally for terms for one year, at which time they may be renewed for another year if both parties agree. The payment of the guarantees would generally be triggered by a continued nonpayment of an obligation owed by the customer to the supplier. The maximum potential amount of future payments (undiscounted) the Company could be required to make under the guarantees in the event of nonperformance by the parties to whom credit or financial guarantees have been extended is represented by the contractual amount of the standby letter of credit. In the event that the Company is required to honor a standby letter of credit, a note, already executed with the customer, is triggered which provides repayment terms and any collateral. Over the past two years, the Company has only had to honor a few standby letters of credit, which have been or are being repaid by the borrower without any loss to the Company. Management expects any draws under existing commitments to be funded through normal operations.

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The Company is not involved in any legal proceedings which, in management's opinion, could have a material effect on the consolidated financial position of the Company.

The Bank grants primarily commercial and installment loans to customers throughout its market area, which consists of Anson, Beaufort, Bladen, Brunswick, Buncombe, Cabarrus, Carteret, Chatham, Columbus, Cumberland, Dare, Davidson, Duplin, Guilford, Harnett, Hoke, Iredell, Lee, Mecklenburg, Montgomery, Moore, New Hanover, Onslow, Pitt, Randolph, Richmond, Robeson, Rockingham, Rowan, Scotland, Stanly and Wake Counties in North Carolina, Chesterfield, Dillon, and Florence Counties in South Carolina, and Montgomery, Roanoke, Washington and Wythe Counties in Virginia. The real estate loan portfolio can be affected by the condition of the local real estate market. The commercial and installment loan portfolios can be affected by local economic conditions.

The Company's loan portfolio is not concentrated in loans to any single borrower or to a relatively small number of borrowers. Additionally, management is not aware of any concentrations of loans to classes of borrowers or industries that would be similarly affected by economic conditions.

In addition to monitoring potential concentrations of loans to particular borrowers or groups of borrowers, industries and geographic regions, the Company monitors exposure to credit risk that could arise from potential concentrations of lending products and practices such as loans that subject borrowers to substantial payment increases (e.g. principal deferral periods, loans with initial interest-only periods, etc), and loans with high loan-to-value ratios. Additionally, there are industry practices that could subject the Company to increased credit risk should economic conditions change over the course of a loan's life. For example, the Company makes variable rate loans and fixed rate principal-amortizing loans with maturities prior to the loan being fully paid (i.e. balloon payment loans). These loans are underwritten and monitored to manage the associated risks. The Company has determined that there is no concentration of credit risk associated with its lending policies or practices.

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The Company's investment portfolio consists principally of obligations of government-sponsored enterprises, mortgage-backed securities guaranteed by government-sponsored enterprises, corporate bonds, and general obligation municipal securities. The Company also holds stock with the Federal Reserve Bank and the Federal Home Loan Bank as a requirement for membership in the system. The following are the fair values at December 31, 2015 of securities to any one issuer/guarantor that exceed \$2.0 million, with such amounts representing the maximum amount of credit risk that the Company would incur if the issuer did not repay the obligation.

(\$ in thousands)

|  | Amortized Cost | Fair Value |
|--|----------------|------------|
| Issuer   |                |            |
| Freddie Mac – mortgage-backed securities                           | \$ 74,835      | 74,529     |
| Fannie Mae – mortgage-backed securities                            | 59,717         | 59,304     |
| Small Business Administration                                      | 46,592         | 45,864     |
| Ginnie Mae - mortgage-backed securities                            | 43,838         | 43,623     |
| Federal Home Loan Bank of Atlanta - common stock                   | 8,846          | 8,846      |
| Federal Reserve Bank - common stock                                | 7,047          | 7,047      |
| Federal Home Loan Bank System - bonds                              | 7,000          | 7,001      |
| Freddie Mac – bonds  | 6,000          | 5,996      |
| Goldman Sachs Group Inc. corporate bond                            | 5,126          | 5,074      |
| Citigroup, Inc. corporate bond                                     | 5,038          | 5,012      |
| JP Morgan Chase corporate bond                                     | 5,031          | 5,001      |
| Bank of America corporate bond                                     | 5,020          | 4,939      |
| Financial Institutions, Inc. corporate bond                        | 4,000          | 3,980      |
| Craven County, North Carolina municipal bond                       | 3,576          | 3,811      |
| Spartanburg, South Carolina Sanitary Sewer District municipal bond | 3,271          | 3,549      |
| Fannie Mae – bonds   | 3,000          | 2,997      |
| Federal Farm Credit bonds  | 3,000          | 2,978      |
| South Carolina State municipal bond                                | 2,161          | 2,391      |
| Virginia State Housing Authority municipal bond                    | 2,066          | 2,204      |

The Company places its deposits and correspondent accounts with the Federal Home Loan Bank of Atlanta, the Federal Reserve Bank, PCBB, and Bank of America and sells its federal funds to Bank of America. At December 31, 2015, the Company had deposits in the Federal Home Loan Bank of Atlanta totaling \$8.7 million, deposits of \$198.4 million in the Federal Reserve Bank, deposits of \$28.2 million in Bank of America, and deposits of \$0.1 million with PCBB. None of the deposits held at the Federal Home Loan Bank of Atlanta or the Federal Reserve Bank are FDIC-insured, however the Federal Reserve Bank is a government entity and therefore risk of loss is minimal. The deposits held at Bank of America and PCBB are FDIC-insured up to \$250,000. The Company also had \$6.1 million in deposits with various holders through an internet-based CD marketplace. All of these deposits are 100% FDIC-insured.

**Note 14. Fair Value of Financial Instruments**

Relevant accounting guidance establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) of identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

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The following table summarizes the Company's financial instruments that were measured at fair value on a recurring and nonrecurring basis at December 31, 2015.

(\$ in thousands)

| Description of Financial Instruments       | Fair Value at December 31, 2015 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant                       |   |
|--|---------------------------------|--|-----------------------------------|---|
|  |                                 |  | Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <b>Recurring</b>                           |                                 |  |                                   |   |
| Securities available for sale:             |                                 |  |                                   |   |
| Government-sponsored enterprise securities | \$ 18,972                       | —  | 18,972                            | —   |
| Mortgage-backed securities                 | 121,553                         | —  | 121,553                           | —   |
| Corporate bonds                            | 24,946                          | —  | 24,946                            | —   |
| Equity securities                          | 143                             | —  | 143                               | —   |
| Total available for sale securities        | \$ 165,614                      | —  | 165,614                           | —   |
| <b>Nonrecurring</b>                        |                                 |  |                                   |   |
| Impaired loans – covered                   | \$ 2,588                        | —  | —                                 | 2,588                                     |
| Impaired loans – non-covered               | 18,057                          | —  | —                                 | 18,057                                    |
| Foreclosed real estate – covered           | 806                             | —  | —                                 | 806                                       |
| Foreclosed real estate – non-covered       | 9,188                           | —  | —                                 | 9,188                                     |

The following table summarizes the Company's financial instruments that were measured at fair value on a recurring and nonrecurring basis at December 31, 2014.

(\$ in thousands)

| Description of Financial Instruments       | Fair Value at December 31, 2014 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant                       |   |
|--|---------------------------------|--|-----------------------------------|---|
|  |                                 |  | Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <b>Recurring</b>                           |                                 |  |                                   |   |
| Securities available for sale:             |                                 |  |                                   |   |
| Government-sponsored enterprise securities | \$ 27,521                       | —  | 27,521                            | —   |
| Mortgage-backed securities                 | 129,510                         | —  | 129,510                           | —   |
| Corporate bonds                            | 865                             | —  | 865                               | —   |
| Equity securities                          | 122                             | —  | 122                               | —   |
| Total available for sale securities        | \$ 158,018                      | —  | 158,018                           | —   |
| <b>Nonrecurring</b>                        |                                 |  |                                   |   |
| Impaired loans – covered                   | \$ 3,991                        | —  | —                                 | 3,991                                     |
| Impaired loans – non-covered               | 18,035                          | —  | —                                 | 18,035                                    |
| Foreclosed real estate – covered           | 2,350                           | —  | —                                 | 2,350                                     |

|                                      |       |   |   |       |
|--------------------------------------|-------|---|---|-------|
| Foreclosed real estate – non-covered | 9,771 | — | — | 9,771 |
|--------------------------------------|-------|---|---|-------|

The following is a description of the valuation methodologies used for instruments measured at fair value.

Securities Available for Sale — When quoted market prices are available in an active market, the securities are classified as Level 1 in the valuation hierarchy. If quoted market prices are not available, but fair values can be estimated by observing quoted prices of securities with similar characteristics, the securities are classified as Level 2 on the valuation hierarchy. Most of the fair values for the Company’s Level 2 securities are determined by our third-party bond accounting provider using matrix pricing. Matrix pricing is a mathematical technique widely used 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. For the Company, Level 2 securities include mortgage-backed securities, collateralized mortgage obligations, government-sponsored enterprise securities, and corporate bonds. In cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

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The Company reviews the pricing methodologies utilized by the bond accounting provider to ensure the fair value determination is consistent with the applicable accounting guidance and that the investments are properly classified in the fair value hierarchy. Further, the Company validates the fair values for a sample of securities in the portfolio by comparing the fair values provided by the bond accounting provider to prices from other independent sources for the same or similar securities. The Company analyzes unusual or significant variances and conducts additional research with the portfolio manager, if necessary, and takes appropriate action based on its findings.

Impaired loans — Fair values for impaired loans in the above table are measured on a non-recurring basis and are based on the underlying collateral values securing the loans, adjusted for estimated selling costs, or the net present value of the cash flows expected to be received for such loans. Collateral may be in the form of real estate or business assets including equipment, inventory and accounts receivable. The vast majority of the collateral is real estate. The value of real estate collateral is determined using an income or market valuation approach based on an appraisal conducted by an independent, licensed third party appraiser (Level 3). The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable borrower's financial statements if not considered significant. Likewise, values for inventory and accounts receivable collateral are based on borrower financial statement balances or aging reports on a discounted basis as appropriate (Level 3). Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income.

Foreclosed real estate – Foreclosed real estate, consisting of properties obtained through foreclosure or in satisfaction of loans, is reported at the lower of cost or fair value. Fair value is measured on a non-recurring basis and is based upon independent market prices or current appraisals that are generally prepared using an income or market valuation approach and conducted by an independent, licensed third party appraiser, adjusted for estimated selling costs (Level 3). At the time of foreclosure, any excess of the loan balance over the fair value of the real estate held as collateral is treated as a charge against the allowance for loan losses. For any real estate valuations subsequent to foreclosure, any excess of the real estate recorded value over the fair value of the real estate is treated as a foreclosed real estate write-down on the Consolidated Statements of Income.

For Level 3 assets and liabilities measured at fair value on a recurring or non-recurring basis as of December 31, 2015, the significant unobservable inputs used in the fair value measurements were as follows:

(\$ in thousands)

| Description                  | Fair Value at December 31, 2015 | Valuation Technique                        | Significant Unobservable Inputs  | General Range of Significant Unobservable Input Values |
|------------------------------|---------------------------------|--|--|--|
| Impaired loans – covered     | \$2,588                         | Appraised value; PV of expected cash flows | Discounts to reflect current market conditions, ultimate collectability, and estimated costs to sell | 0-10%  |
| Impaired loans – non-covered | 18,057                          | Appraised value; PV of expected cash flows | Discounts to reflect current market conditions, ultimate collectability, and                         | 0-10%  |

|                                      |       |   |  |       |
|--------------------------------------|-------|---|--|-------|
| Foreclosed real estate – covered     | 806   | Appraised value; List or contract price | estimated costs to sell<br>Discounts to reflect current market conditions and estimated costs to sell  | 0-10% |
| Foreclosed real estate – non-covered | 9,188 | Appraised value; List or contract price | Discounts to reflect current market conditions, abbreviated holding period and estimated costs to sell | 0-10% |



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For Level 3 assets and liabilities measured at fair value on a recurring or non-recurring basis as of December 31, 2014, the significant unobservable inputs used in the fair value measurements were as follows:

(\$ in thousands)

| Description                          | Fair Value at December 31, 2014 | Valuation Technique                        | Significant Unobservable Inputs  | General Range of Significant Unobservable Input Values |
|--------------------------------------|---------------------------------|--|--|--|
| Impaired loans – covered             | \$ 3,991                        | Appraised value; PV of expected cash flows | Discounts to reflect current market conditions, ultimate collectability, and estimated costs to sell   | 0-10%  |
| Impaired loans – non-covered         | 18,035                          | Appraised value; PV of expected cash flows | Discounts to reflect current market conditions, ultimate collectability, and estimated costs to sell   | 0-10%  |
| Foreclosed real estate – covered     | 2,350                           | Appraised value; List or contract price    | Discounts to reflect current market conditions and estimated costs to sell                             | 0-10%  |
| Foreclosed real estate – non-covered | 9,771                           | Appraised value; List or contract price    | Discounts to reflect current market conditions, abbreviated holding period and estimated costs to sell | 0-10%  |

Transfers of assets or liabilities between levels within the fair value hierarchy are recognized when an event or change in circumstances occurs. There were no transfers between Level 1 and Level 2 for assets or liabilities measured on a recurring basis during the years ended December 31, 2015 or 2014.

For the years ended December 31, 2015 and 2014, the increase (decrease) in the fair value of securities available for sale was (\$473,000) and \$1,329,000, respectively, which is included in other comprehensive income (net of tax expense (benefit) of (\$184,000) and \$518,000, respectively). Fair value measurement methods at December 31, 2015 and 2014 are consistent with those used in prior reporting periods.

As discussed in Note 1(p), the Company is required to disclose estimated fair values for its financial instruments. Fair value estimates as of December 31, 2015 and 2014 and limitations thereon are set forth below for the Company's financial instruments. See Note 1(p) for a discussion of fair value methods and assumptions, as well as fair value information for off-balance sheet financial instruments.

| (\$ in thousands) | Level in Fair Value | December 31, 2015 |                      | December 31, 2014 |                      |
|-------------------|---------------------|-------------------|----------------------|-------------------|----------------------|
|                   |                     | Carrying Amount   | Estimated Fair Value | Carrying Amount   | Estimated Fair Value |

## Hierarchy

|  |         |           |           |           |           |
|--|---------|-----------|-----------|-----------|-----------|
| Cash and due from banks, noninterest-bearing | Level 1 | \$53,285  | \$53,285  | 81,068    | 81,068    |
| Due from banks, interest-bearing             | Level 1 | 213,426   | 213,426   | 171,248   | 171,248   |
| Federal funds sold                           | Level 1 | 557       | 557       | 768       | 768       |
| Securities available for sale                | Level 2 | 165,614   | 165,614   | 158,018   | 158,018   |
| Securities held to maturity                  | Level 2 | 154,610   | 157,146   | 178,687   | 182,411   |
| Presold mortgages in process of settlement   | Level 1 | 4,323     | 4,323     | 6,019     | 6,019     |
| Total loans, net of allowance                | Level 3 | 2,490,343 | 2,484,059 | 2,355,548 | 2,328,244 |
| Accrued interest receivable                  | Level 1 | 9,166     | 9,166     | 8,920     | 8,920     |
| FDIC indemnification asset                   | Level 3 | 8,439     | 8,256     | 22,569    | 21,856    |
| Bank-owned life insurance                    | Level 1 | 72,086    | 72,086    | 55,421    | 55,421    |
| Deposits                                     | Level 2 | 2,811,285 | 2,809,828 | 2,695,906 | 2,696,153 |
| Borrowings                                   | Level 2 | 186,394   | 178,468   | 116,394   | 105,407   |
| Accrued interest payable                     | Level 2 | 585       | 585       | 686       | 686       |

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Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no highly liquid market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on- and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Significant assets and liabilities that are not considered financial assets or liabilities include net premises and equipment, intangible and other assets such as deferred income taxes, prepaid expense accounts, income taxes currently payable and other various accrued expenses. In addition, the income tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of the estimates.

### **Note 15. Equity-Based Compensation Plans**

The Company recorded total stock-based compensation expense of \$710,000, \$270,000 and \$222,000 for the years ended December 31, 2015, 2014, and 2013, respectively. Stock based compensation is reflected as an adjustment to cash flows from operating activities on the Company's Consolidated Statement of Cash Flows. The Company recognized \$277,000, \$105,000, and \$87,000 of income tax benefits related to stock based compensation expense in the income statement for the years ended December 31, 2015, 2014, and 2013, respectively.

At December 31, 2015, the Company had the following equity-based compensation plans: the First Bancorp 2014 Equity Plan, the First Bancorp 2007 Equity Plan, and the First Bancorp 2004 Stock Option Plan. The Company's shareholders approved all equity-based compensation plans. The First Bancorp 2014 Equity Plan became effective upon the approval of shareholders on May 8, 2014. As of December 31, 2015, the First Bancorp 2014 Equity Plan was the only plan that had shares available for future grants, and there were 919,659 shares remaining available for grant.

The First Bancorp 2014 Equity Plan is intended to serve as a means to attract, retain and motivate key employees and directors and to associate the interests of the plans' participants with those of the Company and its shareholders. The First Bancorp 2014 Equity Plan allows for both grants of stock options and other types of equity-based compensation, including stock appreciation rights, restricted stock, restricted performance stock, unrestricted stock, and performance units.

Recent equity grants to employees have either had performance vesting conditions, service vesting conditions, or both. Compensation expense for these grants is recorded over the various service periods based on the estimated number of equity grants that are probable to vest. No compensation cost is recognized for grants that do not vest and any previously recognized compensation cost will be reversed. The Company issues new shares of common stock when options are exercised.

Certain of the Company's stock option grants contain terms that provide for a graded vesting schedule whereby portions of the award vest in increments over the requisite service period. The Company recognizes compensation expense for awards with graded vesting schedules on a straight-line basis over the requisite service period for each incremental award. Compensation expense is based on the estimated number of stock options and awards that will ultimately vest. Over the past five years, there have only been minimal amounts of forfeitures, and therefore the Company assumes that all awards granted without performance conditions will become vested.

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As it relates to director equity grants, the Company grants common shares, valued at approximately \$16,000 to each non-employee director (currently eight in total) in June of each year. Compensation expense associated with these director grants is recognized on the date of grant since there are no vesting conditions. Total stock-based compensation expense related to these grants was \$129,000, \$177,000, and \$193,000 for each the three years ended December 31, 2015, 2014 and 2013, respectively, and is classified as “other operating expense” in the Consolidated Statements of Income.

Pursuant to an employment agreement, the Company granted the chief executive officer 75,000 non-qualified stock options and 40,000 shares of restricted stock during the third quarter of 2012. The option award would have fully vested on December 31, 2014 if the Company achieved a certain earnings target for 2014. The Company did not achieve the applicable target and therefore the award was forfeited as of December 31, 2014. No compensation expense was recognized for the option award. The restricted stock award would have fully vested on December 31, 2015, if the Company achieved a certain earnings target for 2015. The Company did not achieve the applicable target, and therefore the restricted stock award was forfeited as of December 31, 2015. No compensation expense was recognized for the restricted stock award.

Based on the Company’s performance in 2013, the Company granted long-term restricted shares of common stock to the chief executive officer on February 11, 2014 with a two-year vesting period. The total compensation expense associated with the grant was \$278,200. The Company recorded \$92,800 in compensation expense related to this grant during 2015 and 2014.

In 2014, the Company’s Compensation Committee determined that seven of the Company’s senior officers would receive their annual bonus earned under the Company’s annual incentive plan in a mix of 50% cash and 50% stock, with the stock being subject to a three year vesting term. Previously, awards under this plan were paid all in cash. This resulted in the Company granting a total of 14,882 shares of restricted common stock to those officers on February 24, 2015. The total compensation expense associated with this grant was \$258,000, which is being recorded over the vesting period. The Company recorded \$93,100 in compensation expense during 2015 related to these grants.

In 2015, additional stock grants of 50,736 shares were made to 19 officers of the Company, each with three year vesting schedules. The total value of these grants amounted to \$876,000, of which \$395,000 was recorded as expense in during 2015. Grants were issued based on the closing price of the Company’s common stock on the date of grant.

The Company’s equity grants for 2014 were the issuance of 1) 15,657 shares of long-term restricted stock to the chief executive officer on February 11, 2014, at a fair market value of \$17.77 per share, which was the closing price of the Company’s common stock on that date, and 2) 10,065 shares of common stock to non-employee directors on June 2, 2014 (915 shares per director), at a fair market value of \$17.60 per share, which was the closing price of the Company’s common stock on that date.

The Company's equity grants for 2013 were the issuance of 13,164 shares of common stock to non-employee directors on June 3, 2013 (1,097 shares per director), at a fair market value of \$14.68 per share, which was the closing price of the Company's common stock on that date.

Under the terms of the predecessor plans and the First Bancorp 2014 Equity Plan, stock options can have a term of no longer than ten years. In a change in control (as defined in the plans), unless the awards remain outstanding or substitute equivalent awards are provided, the awards become immediately vested ..

At December 31, 2015, there were 117,408 stock options outstanding related to the three First Bancorp plans, with exercise prices ranging from \$14.35 to \$21.83.

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The following table presents information regarding the activity since January 1, 2013 related to all of the Company's stock options outstanding:

|                                  | Options Outstanding |                                 | Weighted-Average Contractual Term (years) | Aggregate Intrinsic Value |
|----------------------------------|---------------------|---------------------------------|---|---------------------------|
|                                  | Number of Shares    | Weighted-Average Exercise Price |   |                           |
| Balance at January 1, 2013       | 487,530             | \$ 17.64                        |   |                           |
| Granted                          | —                   | —                               |   |                           |
| Exercised                        | —                   | —                               |   |                           |
| Forfeited                        | —                   | —                               |   |                           |
| Expired                          | (94,872 )           | 17.36                           |   |                           |
| Balance at December 31, 2013     | 392,658             | \$ 17.71                        |   |                           |
| Granted                          | —                   | —                               |   |                           |
| Exercised                        | (4,500 )            | 15.58                           |   | \$ 6,525                  |
| Forfeited                        | (75,000 )           | 9.76                            |   |                           |
| Expired                          | (134,056)           | 21.10                           |   |                           |
| Balance at December 31, 2014     | 179,102             | \$ 18.55                        |   |                           |
| Granted                          | —                   | —                               |   |                           |
| Exercised                        | (7,353 )            | 15.20                           |   | \$ 19,843                 |
| Forfeited                        | —                   | —                               |   |                           |
| Expired                          | (54,341 )           | 19.93                           |   |                           |
| Outstanding at December 31, 2015 | 117,408             | \$ 18.12                        | 1.57                                      | \$ 206,134                |
| Exercisable at December 31, 2015 | 117,408             | \$ 18.12                        | 1.57                                      | \$ 206,134                |

In 2015 and 2014, the Company received \$112,000 and \$70,000, respectively, as a result of stock option exercises. No stock options were exercised in 2013. The Company recorded insignificant tax benefits from the exercise of nonqualified stock options during the years ended December 31, 2015, 2014, and 2013.

The following table summarizes information about the stock options outstanding at December 31, 2015:

Options Outstanding

Options Exercisable

| Range of           | Number Outstanding at 12/31/15 | Weighted-Average Remaining Contractual Life | Weighted-Average Exercise Price | Number Exercisable at 12/31/15 | Weighted-Average Exercise Price |
|--------------------|--------------------------------|---|---------------------------------|--------------------------------|---------------------------------|
| Exercise Prices    |                                |   |                                 |                                |                                 |
| \$14.35            | 18,000                         | 2.6   | \$ 14.35                        | 18,000                         | \$ 14.35                        |
| \$14.36 to \$17.70 | 49,408                         | 2.0   | 16.64                           | 49,408                         | 16.64                           |
| \$17.70 to \$19.91 | 18,000                         | 1.0   | 19.61                           | 18,000                         | 19.61                           |
| \$19.91 to \$22.12 | 32,000                         | 0.7   | 21.67                           | 32,000                         | 21.67                           |
|                    | 117,408                        | 1.6   | \$ 18.12                        | 117,408                        | \$ 18.12                        |



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The following table presents information regarding the activity during 2013, 2014, and 2015 related to the Company's outstanding restricted stock:

|  | Long-Term Restricted Stock |  |
|--|----------------------------|--|
|  | Number of<br>Units         | Weighted-<br>Average<br>Grant-Date<br>Fair Value |
| Nonvested at January 1, 2013           | 54,344                     | \$ 10.48   |
| Granted during the period              | —                          | —  |
| Vested during the period               | (6,163 )                   | 14.54  |
| Forfeited or expired during the period | (2,807 )                   | 10.96  |
| Nonvested at December 31, 2013         | 45,374                     | \$ 9.90  |
| Granted during the period              | 15,657                     | 17.77  |
| Vested during the period               | (10,593 )                  | 14.32  |
| Forfeited or expired during the period | —                          | —  |
| Nonvested at December 31, 2014         | 50,438                     | \$ 11.42   |
| Granted during the period              | 65,618                     | 17.28  |
| Vested during the period               | (20,117 )                  | 17.44  |
| Forfeited or expired during the period | (40,610 )                  | 9.87   |
| Nonvested at December 31, 2015         | 55,329                     | \$ 17.31   |

**Note 16. Regulatory Restrictions**

The Company is regulated by the Federal Reserve Board (FED) and is subject to securities registration and public reporting regulations of the Securities and Exchange Commission. The Bank is regulated by the FED and the North Carolina Commissioner of Banks. Until April 22, 2015, the Bank was regulated by the FDIC. Effective April 22, 2015, the Bank became a member of the Federal Reserve, and therefore, the FED replaced the FDIC as the Bank's primary federal regulator.

The primary source of funds for the payment of dividends by the Company is dividends received from its subsidiary, the Bank. The Bank, as a North Carolina banking corporation, may pay dividends only out of undivided profits as determined pursuant to North Carolina General Statutes Section 53-87. As of December 31, 2015, the Bank had undivided profits of approximately \$153,305,000 which were available for the payment of dividends (subject to remaining in compliance with regulatory capital requirements). As of December 31, 2015, approximately

\$235,204,000 of the Company's investment in the Bank is restricted as to transfer to the Company without obtaining prior regulatory approval.

The average reserve balance maintained by the Bank under the requirements of the Federal Reserve Board was approximately \$1,702,000 for the year ended December 31, 2015.

The Company and the Bank must comply with regulatory capital requirements established by the FED. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Company's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's and Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

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In 2013, the FED approved final rules implementing the Basel Committee on Banking Supervision capital guidelines, referred to a “Basel III.” The final rules established a new “Common Equity Tier I” ratio; new higher capital ratio requirements, including a capital conservation buffer; narrowed the definitions of capital; imposed new operating restrictions on banking organizations with insufficient capital buffers; and increased the risk weighting of certain assets. The final rules became effective January 1, 2015 for the Company. The capital conservation buffer requirement will be phased in beginning January 1, 2016, at 0.625% of risk weighted assets, increasing each year until fully implemented at 2.5% in January 1, 2019.

As of December 31, 2015, the capital standards require the Company to maintain minimum ratios of “Common Equity Tier I” capital to total risk-weighted assets, “Tier I” capital to total risk-weighted assets, and total capital to risk-weighted assets of 4.50%, 6.00% and 8.00%, respectively. Common Equity Tier I capital is comprised of common stock and related surplus, plus retained earnings, and is reduced by goodwill and other intangible assets, net of associated deferred tax liabilities. Tier I capital is comprised of Common Equity Tier I capital plus Additional Tier I Capital, which for the Company includes non-cumulative perpetual preferred stock and trust preferred securities. Total capital is comprised of Tier I capital plus certain adjustments, the largest of which is our allowance for loan losses. Risk-weighted assets refer to our on- and off-balance sheet exposures, adjusted for their related risk levels using formulas set forth in FED and FDIC regulations.

In addition to the risk-based capital requirements described above, the Company and the Bank are subject to a leverage capital requirement, which calls for a minimum ratio of Tier I capital (as defined above) to quarterly average total assets of 3.00% to 5.00%, depending upon the institution’s composite ratings as determined by its regulators. The FED has not advised the Company of any requirement specifically applicable to it.

In addition to the minimum capital requirements described above, the regulatory framework for prompt corrective action also contains specific capital guidelines applicable to banks for classification as “well capitalized,” which are presented with the minimum ratios, the Company’s ratios and the Bank’s ratios as of December 31, 2015 and 2014 in the following table. Based on the most recent notification from its regulators, the Bank is well capitalized under the framework. There are no conditions or events since that notification that management believes have changed the Company’s classification.

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Also see Note 19 for discussion of preferred stock transactions that have affected the Company's capital ratios.

| (\$ in thousands)                       | Actual    |        | Fully Phased-In<br>Regulatory<br>Guidelines Minimum |        | To Be Well Capitalized<br>Under Current Prompt<br>Corrective Action<br>Provisions |        |
|---|-----------|--------|---|--------|---|--------|
|   | Amount    | Ratio  | Amount<br>(must equal or exceed)                    | Ratio  | Amount<br>(must equal or exceed)  | Ratio  |
| As of December 31, 2015                 |           |        |   |        |   |        |
| Common Equity Tier I Capital Ratio      |           |        |   |        |   |        |
| Company                                 | \$282,766 | 11.22% | \$ 176,344  | 7.00%  | \$ N/A  | N/A    |
| Bank                                    | 332,822   | 13.22% | 176,231   | 7.00%  | 163,643   | 6.50%  |
| Total Capital Ratio                     |           |        |   |        |   |        |
| Company                                 | 364,125   | 14.45% | 264,515   | 10.50% | N/A   | N/A    |
| Bank                                    | 361,405   | 14.36% | 264,347   | 10.50% | 251,759   | 10.00% |
| Tier I Capital Ratio                    |           |        |   |        |   |        |
| Company                                 | 335,053   | 13.30% | 214,131   | 8.50%  | N/A   | N/A    |
| Bank                                    | 332,822   | 13.22% | 213,995   | 8.50%  | 201,407   | 8.00%  |
| Leverage Ratio                          |           |        |   |        |   |        |
| Company                                 | 335,053   | 10.38% | 129,087   | 4.00%  | N/A   | N/A    |
| Bank                                    | 332,822   | 10.32% | 129,014   | 4.00%  | 161,267   | 5.00%  |
| As of December 31, 2014 (pre-Basel III) |           |        |   |        |   |        |
| Total Capital Ratio                     |           |        |   |        |   |        |
| Company                                 | \$393,480 | 17.60% | \$ 178,811  | 8.00%  | \$ N/A  | N/A    |
| Bank                                    | 391,216   | 17.52% | 178,679   | 8.00%  | 223,348   | 10.00% |
| Tier I Capital Ratio                    |           |        |   |        |   |        |
| Company                                 | 365,384   | 16.35% | 89,406  | 4.00%  | N/A   | N/A    |
| Bank                                    | 363,141   | 16.26% | 89,339  | 4.00%  | 134,009   | 6.00%  |
| Leverage Ratio                          |           |        |   |        |   |        |
| Company                                 | 365,384   | 11.61% | 125,856   | 4.00%  | N/A   | N/A    |
| Bank                                    | 363,141   | 11.55% | 125,784   | 4.00%  | 157,229   | 5.00%  |

Table of Contents**Note 17. Supplementary Income Statement Information**

Components of other noninterest income/expense exceeding 1% of total income for any of the years ended December 31, 2015, 2014, and 2013 are as follows:

| (\$ in thousands)  | 2015    | 2014  | 2013  |
|--|---------|-------|-------|
| Other service charges, commissions, and fees – debit card interchange income | \$6,433 | 6,137 | 5,637 |
| Other service charges, commissions, and fees – other interchange income      | 2,288   | 1,786 | 1,402 |
| Other operating expenses – interchange expense                               | 2,181   | 1,728 | 2,508 |
| Other operating expenses – stationery and supplies                           | 2,039   | 1,710 | 2,078 |
| Other operating expenses – telephone and data line expense                   | 2,133   | 1,990 | 1,489 |
| Other operating expenses – FDIC insurance expense                            | 2,394   | 3,988 | 2,803 |
| Other operating expenses – data processing expense                           | 1,935   | 1,654 | —     |
| Other operating expenses – dues and subscriptions                            | 1,710   | 1,716 | 1,580 |
| Other operating expenses – repossession and collection – non-covered         | 2,167   | 2,092 | 2,216 |
| Other operating expenses – outside consultants                               | 1,677   | 1,663 | 2,460 |
| Other operating expenses – legal and audit                                   | 1,689   | 1,955 | 1,204 |
| Other operating expenses – severance pay                                     | 221     | 512   | 1,895 |

**Note 18. Condensed Parent Company Information**

Condensed financial data for First Bancorp (parent company only) follows:

| CONDENSED BALANCE SHEETS<br>(\$ in thousands)      | As of December 31, |         |
|--|--------------------|---------|
|  | 2015               | 2014    |
| Assets   |                    |         |
| Cash on deposit with bank subsidiary               | \$3,816            | 4,272   |
| Investment in wholly-owned subsidiaries, at equity | 384,926            | 430,436 |
| Premises and Equipment                             | 7                  | 7       |
| Other assets                                       | 1,652              | 1,641   |
| Total assets                                       | \$390,401          | 436,356 |
| Liabilities and shareholders' equity               |                    |         |
| Trust preferred securities                         | \$46,394           | 46,394  |

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|  |           |         |
|--|-----------|---------|
| Other liabilities                          | 1,817     | 2,263   |
| Total liabilities                          | 48,211    | 48,657  |
| Shareholders' equity                       | 342,190   | 387,699 |
| Total liabilities and shareholders' equity | \$390,401 | 436,356 |

CONDENSED STATEMENTS OF INCOME  
(\$ in thousands)

Year Ended December 31,  
2015 2014 2013

|   |          |          |          |
|---|----------|----------|----------|
| Dividends from wholly-owned subsidiaries                | \$72,500 | 9,000    | 10,500   |
| Earnings of wholly-owned subsidiaries, net of dividends | (43,328) | 18,343   | 12,102   |
| Interest expense  | (1,032 ) | (1,007 ) | (1,025 ) |
| All other income and expenses, net                      | (1,106 ) | (1,340 ) | (878 )   |
| Net income  | 27,034   | 24,996   | 20,699   |
| Preferred stock dividends                               | (603 )   | (868 )   | (895 )   |
| Net income available to common shareholders             | \$26,431 | 24,128   | 19,804   |

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| CONDENSED STATEMENTS OF CASH FLOWS<br>(\$ in thousands)  | Year Ended December |          |
|--|---------------------|----------|
|  | 2015                | 2014     |
| Operating Activities:  |                     |          |
| Net income   | \$27,034            | 24,996   |
| Excess of dividends over earnings of subsidiaries (Equity in undistributed earnings of subsidiaries) | 43,328              | (18,343) |
| Decrease in other assets   | 1                   | 23       |
| Increase (decrease) in other liabilities   | (272 )              | 489      |
| Total – operating activities   | 70,091              | 7,165    |
| Financing Activities:  |                     |          |
| Payment of preferred and common cash dividends   | (7,105 )            | (7,171 ) |
| Redemption of preferred stock  | (63,500)            | —        |
| Proceeds from issuance of common stock   | 112                 | 70       |
| Stock withheld for payment of taxes  | (54 )               | —        |
| Total - financing activities   | (70,547)            | (7,101 ) |
| Net increase (decrease) in cash  | (456 )              | 64       |
| Cash, beginning of year  | 4,272               | 4,208    |
| Cash, end of year  | \$3,816             | 4,272    |

**Note 19. Shareholders' Equity Transactions***Small Business Lending Fund*

On September 1, 2011, the Company completed the sale of \$63.5 million of Series B Preferred Stock to the Secretary of the Treasury under the Small Business Lending Fund (SBLF). The fund was established under the Small Business Jobs Act of 2010 that was created to encourage lending to small businesses by providing capital to qualified community banks with assets less than \$10 billion.

Under the terms of the stock purchase agreement, the Treasury received 63,500 shares of non-cumulative perpetual preferred stock with a liquidation value of \$1,000 per share, in exchange for \$63.5 million. On June 25, 2015, the Company redeemed \$32 million (32,000 shares) of the outstanding SBLF Stock. The shares were redeemed at their liquidation value of \$1,000 per share plus accrued dividends. On October 16, 2015, the Company redeemed the remaining \$31.5 million (31,500 shares) of the outstanding SBLF Stock. The shares were redeemed at their liquidation value of \$1,000 per share plus accrued dividends. With these redemptions, the Company ended its participation in the SBLF.

The Series B Preferred Stock qualified as Tier 1 capital. The dividend rate, as a percentage of the liquidation amount, fluctuated on a quarterly basis during the first 10 quarters during which the Series B Preferred Stock was outstanding, based upon changes in the level of “Qualified Small Business Lending” or “QSBL”. For the first nine quarters after issuance, the dividend rate could range from one percent (1%) to five percent (5%) per annum based upon the increase in QSBL as compared to the baseline. For the tenth calendar quarter through four and one half years after issuance (the “temporary fixed rate period”), the dividend rate was fixed at between one percent (1%) and seven percent (7%) based upon the level of QSBL compared to the baseline. After four and one half years from the issuance, the dividend rate would increase to nine percent (9%). For quarters subsequent to the issuance in 2011, the Company was able to continually increase its level of small business lending and as a result, the dividend rate has steadily decreased from 5.0% in 2011 to 1.0% in early 2013. From that point through redemption of the Series B Preferred Stock, the Company was in the “temporary fixed rate period,” in which the dividend rate was fixed at 1%.

For the twelve months ended December 31, 2015, 2014 and 2013, the Company accrued approximately \$370,000, \$635,000 and \$662,000, respectively, in preferred dividend payments for the Series B Preferred Stock. This amount is deducted from net income in computing “Net income available to common shareholders.”



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*Stock Issuance*

On December 21, 2012, the Company issued 2,656,294 shares of its common stock and 728,706 shares of the Company's Series C Preferred Stock to certain accredited investors, each at the price of \$10.00 per share, pursuant to a private placement transaction. Net proceeds from this sale of common and preferred stock were \$33.8 million and were used to strengthen and remove risk from the Company's balance sheet in anticipation of a planned disposition of certain classified loans and write-down of foreclosed real estate.

The Series C Preferred Stock qualifies as Tier 1 capital and is Convertible Perpetual Preferred Stock, with dividend rights equal to the Company's Common Stock. Each share of Series C Preferred Stock will automatically convert into one share of Common Stock on the date the holder of Series C Preferred Stock transfers any shares of Series C Preferred Stock to a non-affiliate of the holder in certain permissible transfers. The Series C Preferred Stock is non-voting, except in limited circumstances.

The Series C Preferred Stock pays a dividend per share equal to that of the Company's common stock. During each of 2015, 2014 and 2013, the Company accrued approximately \$233,000 in preferred dividend payments for the Series C Preferred Stock.

**Note 20. Subsequent Events**

On January 1, 2016, the Company completed the acquisition of Bankingport, Inc., an insurance agency based in Sanford, North Carolina. The purchase price was a mix of cash and stock with a total value of approximately \$2.2 million, with additional earn out provisions.

On March 4, 2016, the Company announced that it had entered into an agreement with First Community Bank, Bluefield, Virginia, pursuant to which the Bank is exchanging its branch network in Virginia, which is comprised of seven branches in the southwestern area of Virginia, for six of First Community Bank's branches located in North Carolina. According to the agreement, the Bank will acquire a total of six branches, with four of the branches being in Winston-Salem, one branch being Mooresville and the other branch being in Huntersville. These six branches have total deposits of approximately \$130 million. At the same time, the Bank will sell its all seven of its Virginia branches to First Community Bank, which currently have total deposits of approximately \$150 million. Additionally, the swap will include up to \$175 million of loans. Subject to regulatory approval and the satisfaction of customary closing conditions, the transaction is expected to close in the third quarter of 2016.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders

First Bancorp

Southern Pines, North Carolina

We have audited the accompanying consolidated balance sheets of First Bancorp and subsidiaries (the “Company”) as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2015. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of First Bancorp and subsidiaries as of December 31, 2015 and 2014, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2015, in conformity with U.S. generally accepted accounting principles.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated March 14, 2016 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ Elliott Davis Decosimo, PLLC

Charlotte, North Carolina

March 14, 2016

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders

First Bancorp

Southern Pines, North Carolina

We have audited the internal control over financial reporting of First Bancorp and subsidiaries (the “Company”) as of December 31, 2015, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013 (the “COSO criteria”). The Company’s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management’s Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the effectiveness of the Company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (a) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (b) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (c) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on the COSO criteria.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 31, 2015 and 2014 and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2015 and our report dated March 14, 2016 expressed an unqualified opinion thereon.

/s/ Elliott Davis Decosimo, PLLC

Charlotte, North Carolina

March 14, 2016

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**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures**

None.

**Item 9A. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, which are our controls and other procedures that are designed to ensure that information required to be disclosed in our periodic reports with the SEC is recorded, processed, summarized and reported within the required time periods. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed is communicated to our management to allow timely decisions regarding required disclosure. Based on the evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective in allowing timely decisions regarding disclosure to be made about material information required to be included in our periodic reports with the SEC.

**Management's Report On Internal Control Over Financial Reporting**

Management of First Bancorp and its subsidiaries (the "Company") is responsible for establishing and maintaining effective internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

Under the supervision and with the participation of management, including the principal executive officer and principal financial officer, the Company conducted an evaluation of the effectiveness of internal control over financial reporting based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013). Based on this evaluation under the framework in Internal Control – Integrated Framework, management of the Company has concluded the Company maintained effective internal control over financial reporting, as such term is defined in Securities Exchange Act of 1934 Rules 13a-15(f), as of December 31, 2015.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting can also be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Management is also responsible for the preparation and fair presentation of the consolidated financial statements and other financial information contained in this report. The accompanying consolidated financial statements were prepared in conformity with U.S. generally accepted accounting principles and include, as necessary, best estimates and judgments by management.

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Elliott Davis Decosimo, PLLC, an independent, registered public accounting firm, has audited the Company's consolidated financial statements as of and for the year ended December 31, 2015, and audited the Company's effectiveness of internal control over financial reporting as of December 31, 2015, as stated in their report, which is included in Item 8 hereof.

**Changes in Internal Controls**

There were no changes in our internal control over financial reporting that occurred during, or subsequent to, the fourth quarter of 2015 that were reasonably likely to materially affect our internal control over financial reporting.

**Item 9B. Other Information**

Not applicable.

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance**

Incorporated herein by reference is the information under the captions "Directors, Nominees and Executive Officers," "Section 16(a) Beneficial Ownership Reporting Compliance," "Corporate Governance Policies and Practices" and "Board Committees, Attendance and Compensation" from the Company's definitive proxy statement to be filed pursuant to Regulation 14A.

**Item 11. Executive Compensation**

Incorporated herein by reference is the information under the captions "Executive Compensation" and "Board Committees, Attendance and Compensation" from the Company's definitive proxy statement to be filed pursuant to Regulation 14A.



**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters**

Incorporated herein by reference is the information under the captions “Principal Holders of First Bancorp Voting Securities” and “Directors, Nominees and Executive Officers” from the Company’s definitive proxy statement to be filed pursuant to Regulation 14A.

See also “Additional Information Regarding the Registrant’s Equity Compensation Plans” in Item 5 of this report.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

Incorporated herein by reference is the information under the caption “Certain Transactions” and “Corporate Governance Policies and Practices” from the Company’s definitive proxy statement to be filed pursuant to Regulation 14A.

**Item 14. Principal Accountant Fees and Services**

Incorporated herein by reference is the information under the caption “Audit Committee Report” from the Company’s definitive proxy statement to be filed pursuant to Regulation 14A.

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**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

(a) 1. Financial Statements - See Item 8 and the Cross Reference Index on page 3 for information concerning the Company's consolidated financial statements and report of independent auditors.

2. Financial Statement Schedules - not applicable

3. Exhibits

The following exhibits are filed with this report or, as noted, are incorporated by reference. Except as noted below the exhibits identified have SEC File No. 000-15572. Management contracts, compensatory plans and arrangements are marked with an asterisk (\*).

Articles of Incorporation of the Company and amendments thereto were filed as Exhibits 3.a.i through 3.a.v to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2002, and are incorporated herein by reference. Articles of Amendment to the Articles of Incorporation were filed as Exhibits 3.1 and 3.2 to the Company's Current Report on Form 8-K filed on January 13, 2009, and are incorporated herein by reference.

3.a Articles of Amendment to the Articles of Incorporation were filed as Exhibit 3.1.b to the Company's Registration Statement on Form S-3D filed on June 29, 2010 (Commission File No. 333-167856), and are incorporated herein by reference. Articles of Amendment to the Articles of Incorporation were filed as Exhibit 3.1 to the Company's Current Report on Form 8-K filed on September 6, 2011, and are incorporated herein by reference. Articles of Amendment to the Articles of Incorporation were filed as Exhibit 3.1 to the Company's Current Report on Form 8-K filed on December 26, 2012, and are incorporated herein by reference.

3.b Amended and Restated Bylaws of the Company were filed as Exhibit 3.1 to the Company's Current Report on Form 8-K filed on November 23, 2009, and are incorporated herein by reference.

4.a Form of Common Stock Certificate was filed as Exhibit 4 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1999, and is incorporated herein by reference.

4.b Form of Certificate for Series B Preferred Stock was filed as Exhibit 4.1 to the Company's Current Report on Form 8-K filed on September 6, 2011, and is incorporated herein by reference.

<sup>4.c</sup> Form of Certificate for Series C Preferred Stock was filed as Exhibit 4.1 to the Company's Current Report on Form 8-K filed on December 26, 2012, and is incorporated herein by reference.

10 Material Contracts

10.a Form of Indemnification Agreement between the Company and its Directors and Officers.

<sup>10.b</sup> First Bancorp Senior Management Supplemental Executive Retirement Plan was filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 22, 2006, and is incorporated herein by reference. (\*)

<sup>10.c</sup> First Bancorp 2004 Stock Option Plan was filed as Exhibit B to the Registrant's Form Def 14A filed on March 30, 2004, and is incorporated herein by reference. (\*)

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- 10.d First Bancorp 2007 Equity Plan was filed as Appendix B to the Registrant's Form Def 14A filed on March 27, 2007, and is incorporated herein by reference. (\*)
- 10.e First Bancorp 2014 Equity Plan was filed as Appendix B to the Registrant's Form Def 14A filed on April 4, 2014, and is incorporated herein by reference. (\*)
- 10.f First Bancorp Long Term Care Insurance Plan was filed as Exhibit 10(o) to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2004, and is incorporated by reference. (\*)
- 10.g Advances and Security Agreement with the Federal Home Loan Bank of Atlanta dated February 15, 2005 was attached as Exhibit 99(a) to the Company's Current Report on Form 8-K filed on February 22, 2005, and is incorporated herein by reference.
- 10.h Form of Stock Option and Performance Unit Award Agreement was filed as Exhibit 10 to the Company's Current Report on Form 8-K filed on June 23, 2008, and is incorporated herein by reference. (\*)
- 10.i Description of Director Compensation pursuant to Item 601(b)(10)(iii)(A) of Regulation S-K was filed as Exhibit 10.o to the Company's Annual Report on Form 10-K for the year ended December 31, 2013, and is incorporated herein by reference. (\*)
- 10.j Purchase and Assumption Agreement among Federal Deposit Insurance Corporation, Receiver of Cooperative Bank, Federal Deposit Insurance Corporation and First Bank dated as of June 19, 2009 was filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on June 24, 2009, and is incorporated herein by reference.
- 10.k Form of Restricted Stock Award Agreement under the First Bancorp 2007 Equity Plan was filed as Exhibit 10.u to the Company's Annual Report on Form 10-K for the year ended December 31, 2009, and is incorporated herein by reference. (\*)
- 10.l First Bancorp Employees' Pension Plan, including amendments, was filed as Exhibit 10.v to the Company's Annual Report on Form 10-K for the year ended December 31, 2009, and is incorporated herein by reference. (\*)
- 10.m Purchase and Assumption Agreement among Federal Deposit Insurance Corporation, Receiver of The Bank of Asheville, Federal Deposit Insurance Corporation and First Bank, dated as of January 21, 2011, was filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on January 26, 2011, and is incorporated herein by reference.
- 10.n Securities Purchase Agreement, dated September 1, 2011, between First Bancorp and the Secretary of the Treasury, with respect to the issuance and sale of Series B Preferred Stock, was filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on September 6, 2011, and is incorporated herein by reference.

10.o Repurchase Letter Agreement, dated September 1, 2011, between First Bancorp and the United States Department of the Treasury, with respect to the repurchase and redemption of the Series A Preferred Stock, was filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed on September 6, 2011, and is incorporated herein by reference.

10.p Employment Agreement between the Company and Richard H. Moore dated August 28, 2012 was filed as Exhibit 10.a to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, and is incorporated herein by reference. (\*)

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10.q Securities Purchase Agreement, dated December 21, 2012, between First Bancorp and Purchasers, with respect to the issuance and sale of common stock and the issuance and sale of Series C Preferred Stock, was filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 26, 2012, and is incorporated herein by reference.

10.r Employment Agreement between the Company and Michael G. Mayer dated March 10, 2014 was filed as Exhibit 10.z to the Company's Annual Report on Form 10-K for the year ended December 31, 2013, and is incorporated herein by reference. (\*)

10.s Amendment to the First Bancorp Senior Management Supplemental Executive Retirement Plan dated March 11, 2014 was filed as Exhibit 10.aa to the Company's Annual Report on Form 10-K for the year ended December 31, 2013, and is incorporated herein by reference. (\*)

10.t Employment Agreement between the Company and Edward F. Soccorso dated March 19, 2014 was filed as Exhibit 10.a to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2014, and is incorporated herein by reference. (\*)

10.u The First Bancorp Annual Incentive Plan was filed as Exhibit 10(a) to the Company's Current Report on Form 8-K filed on August 1, 2014, and is incorporated herein by reference. (\*)

10.v Employment Agreement between the Company and Eric P. Credle dated November 7, 2014 was filed as Exhibit 10.a to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2014, and is incorporated herein by reference. (\*)

10.w The Company's Annual Incentive Plan for certain employees and executive officers was filed as Exhibit 10(a) to the Company's Current Report on Form 8-K filed on March 2, 2015, and is incorporated herein by reference. (\*)

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Computation of Ratio of Earnings to Fixed Charges.

21 List of Subsidiaries of Registrant was filed as Exhibit 21 to the Company's Annual Report on Form 10-K for the year ended December 31, 2010 and is incorporated herein by reference.

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Consent of Independent Registered Public Accounting Firm, Elliott Davis Decosimo, PLLC

31.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.

31.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.

- 32.1 Chief Executive Officer Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Chief Financial Officer Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

The following financial information from the Company's Annual Report on Form 10-K for the year ended December 31, 2015, formatted in eXtensible Business Reporting Language (XBRL): (i) the Consolidated Balance Sheet, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Shareholders' Equity, (v) the Consolidated Statements of Cash Flows, and (vi) the Notes to Consolidated Financial Statements.

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(b) Exhibits - see (a)(3) above

(c) No financial statement schedules are filed herewith.

**Copies of exhibits are available upon written request to: First Bancorp, Elizabeth B. Bostian, Secretary, 300 SW Broad Street, Southern Pines, North Carolina, 28387.**



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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, FIRST BANCORP has duly caused this Annual Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Southern Pines, and State of North Carolina, on the 14<sup>th</sup> day of March 2016.

**First Bancorp**

By: /s/ Richard H. Moore

Richard H. Moore

Chief Executive Officer and Treasurer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed on behalf of the Company by the following persons and in the capacities and on the dates indicated.

**Executive Officers**

/s/ Eric P. Credle

/s/ Richard H. Moore

Eric P. Credle

Richard H. Moore

Executive Vice President

Chief Executive Officer and Treasurer      Chief Financial Officer

March 14, 2016

(Principal Accounting Officer)

March 14, 2016

**Board of Directors**

/s/ Mary Clara Capel

/s/ O. Temple Sloan, III

|                                  |                                   |
|----------------------------------|-----------------------------------|
| Mary Clara Capel                 | O. Temple Sloan, III              |
| Chairman of the Board            | Director                          |
| Director                         | March 14, 2016                    |
| March 14, 2016                   |                                   |
| <u>/s/ Daniel T. Blue, Jr.</u>   | <u>/s/ Frederick L. Taylor II</u> |
| Daniel T. Blue, Jr.              | Frederick L. Taylor II            |
| Director                         | Director                          |
| March 14, 2016                   | March 14, 2016                    |
| <u>s/ James C. Crawford, III</u> | <u>/s/ Virginia C. Thomasson</u>  |
| James C. Crawford, III           | Virginia C. Thomasson             |
| Director                         | Director                          |
| March 14, 2016                   | March 14, 2016                    |
| <u>/s/ Richard H. Moore</u>      | <u>/s/ Dennis A. Wicker</u>       |
| Richard H. Moore                 | Dennis A. Wicker                  |
| Director                         | Director                          |
| March 14, 2016                   | March 14, 2016                    |
| <u>/s/ Thomas F. Phillips</u>    |                                   |
| Thomas F. Phillips               |                                   |
| Director                         |                                   |
| March 14, 2016                   |                                   |