

FIRST BANCORP /NC/  
Form 10-Q  
May 10, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended March 31, 2016

Commission File Number 0-15572

**FIRST BANCORP**

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(Exact Name of Registrant as Specified in its Charter)

North Carolina

56-1421916

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(State or Other Jurisdiction of  
Incorporation or Organization)

(I.R.S. Employer  
Identification Number)

300 SW Broad St., Southern Pines, North Carolina  
(Address of Principal Executive Offices)

28387  
(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve 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. x YES  
o 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). x YES  
o NO

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 number of shares of the registrant's Common Stock outstanding on April 30, 2016 was 19,870,270.

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**FORWARD-LOOKING STATEMENTS**

Part I of 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 of our 2015 Annual Report on Form 10-K.

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Index**Part I. Financial Information**

## Item 1 - Financial Statements

**First Bancorp and Subsidiaries****Consolidated Balance Sheets**

| (\$ in thousands-unaudited)                                                      | March 31,<br>2016 | December<br>31,<br>2015<br>(audited) | March 31,<br>2015 |
|----------------------------------------------------------------------------------|-------------------|--------------------------------------|-------------------|
| <b>ASSETS</b>                                                                    |                   |                                      |                   |
| Cash and due from banks, noninterest-bearing                                     | \$52,393          | 53,285                               | 84,208            |
| Due from banks, interest-bearing                                                 | 148,734           | 213,426                              | 159,527           |
| Federal funds sold                                                               | 467               | 557                                  | 752               |
| Total cash and cash equivalents                                                  | 201,594           | 267,268                              | 244,487           |
| Securities available for sale                                                    | 247,140           | 165,614                              | 172,319           |
| Securities held to maturity (fair values of \$151,684, \$157,146, and \$174,756) | 148,485           | 154,610                              | 170,804           |
| Presold mortgages in process of settlement                                       | 3,102             | 4,323                                | 8,273             |
| Loans – non-covered                                                              | 2,439,830         | 2,416,285                            | 2,275,570         |
| Loans – covered by FDIC loss share agreement                                     | 99,523            | 102,641                              | 119,829           |
| Total loans                                                                      | 2,539,353         | 2,518,926                            | 2,395,399         |
| Allowance for loan losses – non-covered                                          | (25,249 )         | (26,784 )                            | (33,770 )         |
| Allowance for loan losses – covered                                              | (1,399 )          | (1,799 )                             | (2,226 )          |
| Total allowance for loan losses                                                  | (26,648 )         | (28,583 )                            | (35,996 )         |
| Net loans                                                                        | 2,512,705         | 2,490,343                            | 2,359,403         |
| Premises and equipment                                                           | 75,268            | 74,559                               | 75,573            |
| Accrued interest receivable                                                      | 8,986             | 9,166                                | 8,744             |
| FDIC indemnification asset                                                       | 6,704             | 8,439                                | 18,452            |
| Goodwill                                                                         | 67,528            | 65,835                               | 65,835            |
| Other intangible assets                                                          | 1,833             | 1,336                                | 1,877             |
| Foreclosed real estate – non-covered                                             | 8,767             | 9,188                                | 8,978             |
| Foreclosed real estate – covered                                                 | 1,569             | 806                                  | 2,055             |
| Bank-owned life insurance                                                        | 72,594            | 72,086                               | 55,793            |
| Other assets                                                                     | 26,691            | 38,492                               | 26,995            |
| Total assets                                                                     | \$3,382,966       | 3,362,065                            | 3,219,588         |
| <b>LIABILITIES</b>                                                               |                   |                                      |                   |
| Deposits: Noninterest bearing checking accounts                                  | \$679,228         | 659,038                              | 591,283           |
| Interest bearing checking accounts                                               | 607,617           | 626,878                              | 578,784           |

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|                                    |           |           |           |
|------------------------------------|-----------|-----------|-----------|
| Money market accounts              | 667,504   | 639,189   | 571,124   |
| Savings accounts                   | 194,573   | 186,616   | 183,036   |
| Time deposits of \$100,000 or more | 391,317   | 403,545   | 433,942   |
| Other time deposits                | 286,582   | 296,019   | 335,445   |
| Total deposits                     | 2,826,821 | 2,811,285 | 2,693,614 |
| Borrowings                         | 186,394   | 186,394   | 116,394   |
| Accrued interest payable           | 554       | 585       | 619       |
| Other liabilities                  | 19,365    | 21,611    | 15,717    |
| Total liabilities                  | 3,033,134 | 3,019,875 | 2,826,344 |

Commitments and contingencies

SHAREHOLDERS' EQUITY

|                                                                                   |             |           |           |
|-----------------------------------------------------------------------------------|-------------|-----------|-----------|
| Preferred stock, no par value per share. Authorized: 5,000,000 shares             |             |           |           |
| Series B issued & outstanding: None, None, and 63,500 shares                      | —           | —         | 63,500    |
| Series C, convertible, issued & outstanding: 728,706, 728,706, and 728,706 shares | 7,287       | 7,287     | 7,287     |
| Common stock, no par value per share. Authorized: 40,000,000 shares               |             |           |           |
| Issued & outstanding: 19,865,779, 19,747,509, and 19,740,183 shares               | 135,318     | 133,393   | 132,752   |
| Retained earnings                                                                 | 210,250     | 205,060   | 190,150   |
| Accumulated other comprehensive income (loss)                                     | (3,023 )    | (3,550 )  | (445 )    |
| Total shareholders' equity                                                        | 349,832     | 342,190   | 393,244   |
| Total liabilities and shareholders' equity                                        | \$3,382,966 | 3,362,065 | 3,219,588 |

*See accompanying notes to consolidated financial statements.*

Index**First Bancorp and Subsidiaries****Consolidated Statements of Income**

| (\$ in thousands, except share data-unaudited)             |  | Three Months Ended<br>March 31, |          |
|------------------------------------------------------------|--|---------------------------------|----------|
|                                                            |  | 2016                            | 2015     |
| <b>INTEREST INCOME</b>                                     |  |                                 |          |
| Interest and fees on loans                                 |  | \$29,573                        | 29,441   |
| Interest on investment securities:                         |  |                                 |          |
| Taxable interest income                                    |  | 1,823                           | 1,359    |
| Tax-exempt interest income                                 |  | 445                             | 463      |
| Other, principally overnight investments                   |  | 222                             | 195      |
| Total interest income                                      |  | 32,063                          | 31,458   |
| <b>INTEREST EXPENSE</b>                                    |  |                                 |          |
| Savings, checking and money market accounts                |  | 394                             | 269      |
| Time deposits of \$100,000 or more                         |  | 652                             | 847      |
| Other time deposits                                        |  | 274                             | 342      |
| Borrowings                                                 |  | 548                             | 297      |
| Total interest expense                                     |  | 1,868                           | 1,755    |
| Net interest income                                        |  | 30,195                          | 29,703   |
| Provision for loan losses – non-covered                    |  | 1,621                           | 104      |
| Provision (reversal) for loan losses – covered             |  | (1,363                          | ) (268   |
| Total provision (reversal) for loan losses                 |  | 258                             | (164     |
| Net interest income after provision for loan losses        |  | 29,937                          | 29,867   |
| <b>NONINTEREST INCOME</b>                                  |  |                                 |          |
| Service charges on deposit accounts                        |  | 2,685                           | 2,892    |
| Other service charges, commissions and fees                |  | 2,830                           | 2,542    |
| Fees from presold mortgage loans                           |  | 371                             | 808      |
| Commissions from sales of insurance and financial products |  | 938                             | 561      |
| Bank-owned life insurance income                           |  | 508                             | 371      |
| Foreclosed property gains (losses) – non-covered           |  | (237                            | ) (494   |
| Foreclosed property gains (losses) – covered               |  | 447                             | 237      |
| FDIC indemnification asset income (expense), net           |  | (2,366                          | ) (2,392 |
| Securities gains (losses)                                  |  | 3                               | —        |
| Other gains (losses)                                       |  | (177                            | ) 4      |
| Total noninterest income                                   |  | 5,002                           | 4,529    |
| <b>NONINTEREST EXPENSES</b>                                |  |                                 |          |
| Salaries                                                   |  | 11,475                          | 11,497   |
| Employee benefits                                          |  | 2,706                           | 2,183    |
| Total personnel expense                                    |  | 14,181                          | 13,680   |
| Net occupancy expense                                      |  | 1,943                           | 1,869    |
| Equipment related expenses                                 |  | 870                             | 956      |

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|                                             |            |            |
|---------------------------------------------|------------|------------|
| Intangibles amortization                    | 186        | 180        |
| Other operating expenses                    | 7,593      | 7,029      |
| Total noninterest expenses                  | 24,773     | 23,714     |
| Income before income taxes                  | 10,166     | 10,682     |
| Income tax expense                          | 3,329      | 3,694      |
| Net income                                  | 6,837      | 6,988      |
| Preferred stock dividends                   | (58 )      | (217 )     |
| Net income available to common shareholders | \$6,779    | 6,771      |
| Earnings per common share:                  |            |            |
| Basic                                       | \$0.34     | 0.34       |
| Diluted                                     | 0.33       | 0.33       |
| Dividends declared per common share         | \$0.08     | 0.08       |
| Weighted average common shares outstanding: |            |            |
| Basic                                       | 19,783,747 | 19,721,992 |
| Diluted                                     | 20,553,858 | 20,454,614 |

*See accompanying notes to consolidated financial statements.*



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**First Bancorp and Subsidiaries**

**Consolidated Statements of Comprehensive Income**

| (\$ in thousands-unaudited)                                         | Three Months Ended<br>March 31, |       |
|---------------------------------------------------------------------|---------------------------------|-------|
|                                                                     | 2016                            | 2015  |
| Net income                                                          | \$ 6,837                        | 6,988 |
| Other comprehensive income (loss):                                  |                                 |       |
| Unrealized gains (losses) on securities available for sale:         |                                 |       |
| Unrealized holding gains (losses) arising during the period, pretax | 817                             | 247   |
| Tax (expense) benefit                                               | (319 )                          | (95 ) |
| Reclassification to realized (gains) losses                         | (3 )                            | —     |
| Tax expense (benefit)                                               | 1                               | —     |
| Postretirement Plans:                                               |                                 |       |
| Amortization of unrecognized net actuarial (gain) loss              | 51                              | (31 ) |
| Tax expense (benefit)                                               | (20 )                           | 12    |
| Other comprehensive income (loss)                                   | 527                             | 133   |
| Comprehensive income                                                | \$ 7,364                        | 7,121 |

*See accompanying notes to consolidated financial statements.*

Index**First Bancorp and Subsidiaries****Consolidated Statements of Shareholders' Equity**

| <i>(In thousands, except per share -<br/>unaudited)</i> | Preferred | Common Stock |           | Retained | Accumulated                                | Total                        |
|---------------------------------------------------------|-----------|--------------|-----------|----------|--------------------------------------------|------------------------------|
|                                                         | Stock     | Shares       | Amount    | Earnings | Other<br>Comprehensive<br>Income<br>(Loss) | Share-<br>holders'<br>Equity |
| Balances, January 1, 2015                               | \$70,787  | 19,710       | \$132,532 | 184,958  | (578 )                                     | 387,699                      |
| Net income                                              |           |              |           | 6,988    |                                            | 6,988                        |
| Cash dividends declared (\$0.08 per common share)       |           |              |           | (1,579 ) |                                            | (1,579 )                     |
| Preferred dividends                                     |           |              |           | (217 )   |                                            | (217 )                       |
| Stock-based compensation                                |           | 30           | 220       |          |                                            | 220                          |
| Other comprehensive income (loss)                       |           |              |           |          | 133                                        | 133                          |
| Balances, March 31, 2015                                | \$70,787  | 19,740       | \$132,752 | 190,150  | (445 )                                     | 393,244                      |
| Balances, January 1, 2016                               | \$7,287   | 19,748       | \$133,393 | 205,060  | (3,550 )                                   | 342,190                      |
| Net income                                              |           |              |           | 6,837    |                                            | 6,837                        |
| Cash dividends declared (\$0.08 per common share)       |           |              |           | (1,589 ) |                                            | (1,589 )                     |
| Preferred dividends                                     |           |              |           | (58 )    |                                            | (58 )                        |
| Shares issued pursuant to acquisition                   |           | 79           | 1,500     |          |                                            | 1,500                        |
| Stock option exercises                                  |           | 8            | 127       |          |                                            | 127                          |
| Stock-based compensation                                |           | 31           | 298       |          |                                            | 298                          |
| Other comprehensive income (loss)                       |           |              |           |          | 527                                        | 527                          |
| Balances, March 31, 2016                                | \$7,287   | 19,866       | \$135,318 | 210,250  | (3,023 )                                   | 349,832                      |

*See accompanying notes to consolidated financial statements.*

Index**First Bancorp and Subsidiaries****Consolidated Statements of Cash Flows**

|                                                                               | Three Months Ended<br>March 31, |           |
|-------------------------------------------------------------------------------|---------------------------------|-----------|
| (\$ in thousands-unaudited)                                                   | 2016                            | 2015      |
| <b>Cash Flows From Operating Activities</b>                                   |                                 |           |
| Net income                                                                    | \$6,837                         | 6,988     |
| Reconciliation of net income to net cash provided by operating activities:    |                                 |           |
| Provision (reversal) for loan losses                                          | 258                             | (164 )    |
| Net security premium amortization                                             | 680                             | 802       |
| Purchase accounting accretion and amortization, net                           | 1,036                           | 835       |
| Foreclosed property (gains) losses and write-downs, net                       | (210 )                          | 257       |
| Gain on securities available for sale                                         | (3 )                            | —         |
| Other losses (gains)                                                          | 177                             | (4 )      |
| Decrease (increase) in net deferred loan costs                                | (385 )                          | 163       |
| Depreciation of premises and equipment                                        | 1,120                           | 1,132     |
| Stock-based compensation expense                                              | 123                             | 127       |
| Amortization of intangible assets                                             | 186                             | 180       |
| Origination of presold mortgages in process of settlement                     | (13,988 )                       | (30,651 ) |
| Proceeds from sales of presold mortgages in process of settlement             | 15,230                          | 28,364    |
| Decrease in accrued interest receivable                                       | 180                             | 176       |
| Decrease (increase) in other assets                                           | 11,405                          | (3,116 )  |
| Decrease in accrued interest payable                                          | (31 )                           | (67 )     |
| Decrease in other liabilities                                                 | (2,762 )                        | (1,921 )  |
| Net cash provided by operating activities                                     | 19,853                          | 3,101     |
| <b>Cash Flows From Investing Activities</b>                                   |                                 |           |
| Purchases of securities available for sale                                    | (99,896 )                       | (30,535 ) |
| Purchases of securities held to maturity                                      | —                               | (1,146 )  |
| Proceeds from maturities/issuer calls of securities available for sale        | 18,852                          | 16,249    |
| Proceeds from maturities/issuer calls of securities held to maturity          | 5,772                           | 8,459     |
| Proceeds from sales of securities available for sale                          | 8                               | —         |
| Proceeds (purchases) of Federal Reserve and Federal Home Loan Bank stock, net | (138 )                          | 145       |
| Net increase in loans                                                         | (23,170 )                       | (3,869 )  |
| Proceeds (payments) related to FDIC loss share agreements                     | (356 )                          | 2,282     |
| Proceeds from sales of foreclosed real estate                                 | 1,858                           | 2,403     |
| Purchases of premises and equipment                                           | (925 )                          | (1,600 )  |
| Proceeds from sales of premises and equipment                                 | 21                              | —         |
| Net cash paid in acquisition                                                  | (1,580 )                        | —         |
| Net cash used by investing activities                                         | (99,554 )                       | (7,612 )  |
| <b>Cash Flows From Financing Activities</b>                                   |                                 |           |
| Net increase (decrease) in deposits                                           | 15,536                          | (2,292 )  |
| Cash dividends paid – common stock                                            | (1,578 )                        | (1,577 )  |
| Cash dividends paid – preferred stock                                         | (58 )                           | (217 )    |

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|                                                                       |            |          |
|-----------------------------------------------------------------------|------------|----------|
| Proceeds from stock option exercises                                  | 127        | —        |
| Net cash provided (used) by financing activities                      | 14,027     | (4,086 ) |
| Decrease in cash and cash equivalents                                 | (65,674 )  | (8,597 ) |
| Cash and cash equivalents, beginning of period                        | 267,268    | 253,084  |
| Cash and cash equivalents, end of period                              | \$ 201,594 | 244,487  |
| Supplemental Disclosures of Cash Flow Information:                    |            |          |
| Cash paid (received) during the period for:                           |            |          |
| Interest                                                              | \$ 1,899   | 1,822    |
| Income taxes                                                          | (4,305 )   | 6,212    |
| Non-cash transactions:                                                |            |          |
| Unrealized gain (loss) on securities available for sale, net of taxes | 496        | 152      |
| Foreclosed loans transferred to other real estate                     | 1,990      | 1,572    |

*See accompanying notes to consolidated financial statements.*

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**First Bancorp and Subsidiaries**

**Notes to Consolidated Financial Statements**

*(unaudited)* For the Periods Ended March 31, 2016 and 2015

**Note 1 - Basis of Presentation**

In the opinion of the Company, the accompanying unaudited consolidated financial statements contain all adjustments necessary to present fairly the consolidated financial position of the Company as of March 31, 2016 and 2015 and the consolidated results of operations and consolidated cash flows for the periods ended March 31, 2016 and 2015. All such adjustments were of a normal, recurring nature. Reference is made to the 2015 Annual Report on Form 10-K filed with the SEC for a discussion of accounting policies and other relevant information with respect to the financial statements. The results of operations for the periods ended March 31, 2016 and 2015 are not necessarily indicative of the results to be expected for the full year. The Company has evaluated all subsequent events through the date the financial statements were issued.

**Note 2 – Accounting Policies**

Note 1 to the 2015 Annual Report on Form 10-K filed with the SEC contains a description of the accounting policies followed by the Company and discussion of recent accounting pronouncements. The following paragraphs update that information as necessary.

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 were effective for the Company on January 1, 2016. The Company will apply the guidance to all stock awards granted or modified after January 1, 2016. The Company's adoption of these amendments did not have a material effect on its financial statements.

In January 2015, the FASB issued guidance to eliminate from U.S. GAAP the concept of an extraordinary item, which is an event or transaction that is both (1) unusual in nature and (2) infrequently occurring. Under the new guidance, an entity will no longer (1) segregate an extraordinary item from the results of ordinary operations; (2) separately present an extraordinary item on its income statement, net of tax, after income from continuing operations; or (3) disclose income taxes and earnings-per-share data applicable to an extraordinary item. The amendments were effective for the

Company on January 1, 2016, and did not 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 were expected to result in the deconsolidation of many entities. The amendments were effective for the Company on January 1, 2016. The adoption of these amendments did not have a material effect on the Company's 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 were effective for the Company on January 1, 2016. The Company's adoption of these amendments did not 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 were effective for the Company on January 1, 2016. The Company's adoption of these amendments did not 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 were subject to transition guidance were effective for the Company on January 1, 2016. The adoption of this guidance did not have a material effect on the Company's 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. The Company is evaluating the effect that this new guidance will have on our consolidated financial statements, but does not expect it will have a material effect on its financial statements.

In March 2016, the FASB amended the Liabilities topic of the Accounting Standards Codification to address the current and potential future diversity in practice related to the derecognition of a prepaid stored-value product liability. The amendments will be effective for financial statements issued for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company will apply the guidance using a modified retrospective transition method by means of a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year in which the guidance is effective to each period presented. The Company does not expect these amendments to have a material effect on its financial statements.

In March 2016, the FASB amended the Investments—Equity Method and Joint Ventures topic of the Accounting Standards Codification to eliminate the requirement to retroactively adopt the equity method of accounting. The amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. The Company will apply the guidance prospectively upon their effective date to increases in the level of ownership interest or degree of influence that result in the adoption of the equity method. The Company does not expect these amendments to have a material effect on its financial statements.

In March 2016, the FASB amended the Revenue from Contracts with Customers topic of the Accounting Standards Codification to clarify the implementation guidance on principal versus agent considerations and address how an entity should assess whether it is the principal or the agent in contracts that include three or more parties. The amendments will be effective for the Company for reporting periods beginning after December 15, 2017. The Company does not expect these amendments to have a material effect on its financial statements.

In March 2016, the FASB issued guidance to simplify several aspects of the accounting for share-based payment award transactions including the income tax consequences, the classification of awards as either equity or liabilities, and the classification on the statement of cash flows. Additionally, the guidance simplifies two areas specific to entities other than public business entities allowing them apply a practical expedient to estimate the expected term for all awards with performance or service conditions that have certain characteristics and also allowing them to make a one-time election to switch from measuring all liability-classified awards at fair value to measuring them at intrinsic value. The amendments will be effective for the Company for annual periods beginning after December 15, 2016 and interim periods within those annual periods. The Company does not expect these amendments to have a material effect on its financial statements.

In April 2016, the FASB amended the Revenue from Contracts with Customers topic of the Accounting Standards Codification to clarify the guidance related to identifying performance obligations and licensing. The amendments

will be effective for the Company for reporting periods beginning after December 15, 2017. The Company does not expect these amendments 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 3 – Reclassifications

Certain amounts reported in the period ended March 31, 2015 have been reclassified to conform to the presentation for March 31, 2016. These reclassifications had no effect on net income or shareholders' equity for the periods presented, nor did they materially impact trends in financial information.

#### Note 4 – Equity-Based Compensation Plans

The Company recorded total stock-based compensation expense of \$123,000 and \$127,000 for the three months ended March 31, 2016 and 2015, 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 \$48,000 and \$50,000 of income tax benefits related to stock based compensation expense in the income statement for the three months ended March 31, 2016 and 2015, respectively.



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At March 31, 2016, 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 March 31, 2016, the First Bancorp 2014 Equity Plan was the only plan that had shares available for future grants, and there were 888,381 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.

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.

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 \$23,200 in compensation expense related to this grant during the three months ended March 31, 2015.

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 \$11,200 and \$23,300 in compensation expense during the three months ended March 31, 2016 and 2015, respectively, related to these grants and expects to record \$11,200 in compensation expense during each remaining quarter of 2016.

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 \$65,700 and \$80,500 was recorded as compensation expense during the first quarters of 2016 and 2015, respectively. Grants were issued based on the closing price of the Company's common stock on the date of the grant.

On February 23, 2016, the Company granted a total of 26,032 shares of restricted common stock to eleven senior officers for the attainment of goals related to the Company's annual incentive plan in 2015. The total compensation expense with the grant was \$484,000, which is being recorded over the three-year vesting period. The Company recorded \$43,700 in compensation expense during the three months ended March 31, 2016 related to these grants, and expects to record \$43,700 in each remaining quarter of 2016.

On March 1, 2016, the Company granted 5,266 shares of restricted common stock to an officer with a three year vesting period. Total compensation expense associated with the grant was \$100,000. The Company recorded \$3,000 in compensation expense during the three months ended March 31, 2016, and expects to record \$8,000 in each remaining quarter of 2016.

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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 March 31, 2016, there were 109,448 stock options outstanding related to the three First Bancorp plans, with exercise prices ranging from \$14.35 to \$21.83.

The following table presents information regarding the activity for the first three months of 2016 related to the Company's stock options outstanding:

|                               | Options Outstanding |                                 |                                           |                           |
|-------------------------------|---------------------|---------------------------------|-------------------------------------------|---------------------------|
|                               | Number of Shares    | Weighted-Average Exercise Price | Weighted-Average Contractual Term (years) | Aggregate Intrinsic Value |
| Balance at January 1, 2016    | 117,408             | \$ 18.12                        |                                           |                           |
| Granted                       | —                   | —                               |                                           |                           |
| Exercised                     | (7,960 )            | 15.99                           |                                           | \$ 17,263                 |
| Forfeited                     | —                   | —                               |                                           |                           |
| Expired                       | —                   | —                               |                                           |                           |
| Outstanding at March 31, 2016 | 109,448             | \$ 18.27                        | 1.3                                       | \$ 179,698                |
| Exercisable at March 31, 2016 | 109,448             | \$ 18.27                        | 1.3                                       | \$ 179,698                |

During the three months ended March 31, 2016, the Company received \$127,000 as a result of stock option exercises and recorded insignificant tax benefits from the exercise of nonqualified options during the period. The Company did not have any stock option exercises during the three months ended March 31, 2015.

The following table presents information regarding the activity the first three months of 2016 related to the Company's outstanding restricted stock:

| Long-Term Restricted Stock |                                        |
|----------------------------|----------------------------------------|
| Number of Units            | Weighted-Average Grant-Date Fair Value |

|                                        |          |    |       |
|----------------------------------------|----------|----|-------|
| Nonvested at January 1, 2016           | 55,329   | \$ | 17.31 |
| Granted during the period              | 31,298   |    | 18.65 |
| Vested during the period               | (5,219 ) |    | 17.77 |
| Forfeited or expired during the period | —        |    | —     |
| Nonvested at March 31, 2016            | 81,408   | \$ | 17.80 |

#### Note 5 – Earnings Per Common Share

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, with nonvested restricted stock excluded from the calculation. 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. The Company's potentially dilutive common stock issuances relate to stock option and nonvested restricted stock grants under the Company's equity-based compensation plans and the Company's Series C Preferred Stock, which is convertible into common stock on a one-for-one ratio.

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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 nonvested restricted stock, proceeds equal to the average amount of compensation cost attributable to future services and not yet recognized in earnings are assumed to be used by the Company to buy back stock in the open market and are deducted from the total number of nonvested restricted stock that is included in the denominator of the calculation. 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, the potentially dilutive common stock issuance is disregarded.

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

|                                                   | For the Three Months Ended March 31, |                         |                     |                       |                         |                     |
|---------------------------------------------------|--------------------------------------|-------------------------|---------------------|-----------------------|-------------------------|---------------------|
|                                                   | 2016                                 |                         |                     | 2015                  |                         |                     |
| <i>(\$ in thousands except per share amounts)</i> | Income<br>(Numerator)                | Shares<br>(Denominator) | Per Share<br>Amount | Income<br>(Numerator) | Shares<br>(Denominator) | Per Share<br>Amount |
| Basic EPS                                         |                                      |                         |                     |                       |                         |                     |
| Net income available to common shareholders       | \$6,779                              | 19,783,747              | \$ 0.34             | \$6,771               | 19,721,992              | \$ 0.34             |
| Effect of Dilutive Securities                     | 58                                   | 770,111                 |                     | 58                    | 732,622                 |                     |
| Diluted EPS per common share                      | \$6,837                              | 20,553,858              | \$ 0.33             | \$6,829               | 20,454,614              | \$ 0.33             |

For the three months ended March 31, 2016 and 2015, there were 50,000 options and 84,000 options, respectively, that were antidilutive because the exercise price exceeded the average market price for the period, and thus are not included in the calculation to determine the effect of dilutive securities.

Note 6 – Securities

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The book values and approximate fair values of investment securities at March 31, 2016 and December 31, 2015 are summarized as follows:

| (\$ in thousands)                          | March 31, 2016 |            | Unrealized |          | December 31, 2015 |            | Unrealized |          |
|--------------------------------------------|----------------|------------|------------|----------|-------------------|------------|------------|----------|
|                                            | Amortized Cost | Fair Value |            |          | Amortized Cost    | Fair Value |            |          |
| Securities available for sale:             |                |            |            |          |                   |            |            |          |
| Government-sponsored enterprise securities | \$38,638       | 38,636     | 4          | (6 )     | 19,000            | 18,972     | 1          | (29 )    |
| Mortgage-backed securities                 | 174,905        | 174,579    | 666        | (992 )   | 122,474           | 121,553    | 348        | (1,269 ) |
| Corporate bonds                            | 33,863         | 33,798     | 126        | (191 )   | 25,216            | 24,946     | —          | (270 )   |
| Equity securities                          | 83             | 127        | 53         | (9 )     | 88                | 143        | 64         | (9 )     |
| Total available for sale                   | \$247,489      | 247,140    | 849        | (1,198 ) | 166,778           | 165,614    | 413        | (1,577 ) |
| Securities held to maturity:               |                |            |            |          |                   |            |            |          |
| Mortgage-backed securities                 | \$98,102       | 98,030     | 87         | (159 )   | 102,509           | 101,767    | —          | (742 )   |
| State and local governments                | 50,383         | 53,654     | 3,273      | (2 )     | 52,101            | 55,379     | 3,284      | (6 )     |
| Total held to maturity                     | \$148,485      | 151,684    | 3,360      | (161 )   | 154,610           | 157,146    | 3,284      | (748 )   |

All of the Company's mortgage-backed securities were issued by government-sponsored corporations.

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The following table presents information regarding securities with unrealized losses at March 31, 2016:

| (\$ 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 | \$ —                                                                       | —                    | 2,994                                                                      | 6                    | 2,994         | 6                    |
| Mortgage-backed securities                 | 117,206                                                                    | 602                  | 25,136                                                                     | 549                  | 142,342       | 1,151                |
| Corporate bonds                            | 13,926                                                                     | 131                  | 940                                                                        | 60                   | 14,866        | 191                  |
| Equity securities                          | —                                                                          | —                    | 17                                                                         | 9                    | 17            | 9                    |
| State and local governments                | 841                                                                        | 2                    | —                                                                          | —                    | 841           | 2                    |
| Total temporarily impaired securities      | \$ 131,973                                                                 | 735                  | 29,087                                                                     | 624                  | 161,060       | 1,359                |

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

| (\$ 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 | \$ 5,993                                                                   | 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                  |
| 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                |

In the above tables, all of the non-equity securities that were in an unrealized loss position at March 31, 2016 and December 31, 2015 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 also concluded that each of the equity securities in an unrealized loss position at March 31, 2016 and December 31, 2015 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 March 31, 2016, 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<br>Cost             | Fair<br>Value | Amortized<br>Cost           | Fair<br>Value |
| Debt securities                           |                               |               |                             |               |
| Due within one year                       | \$ —                          | —             | 1,308                       | 1,340         |
| Due after one year but within five years  | 10,639                        | 10,635        | 12,630                      | 13,253        |
| Due after five years but within ten years | 56,862                        | 56,919        | 35,268                      | 37,882        |
| Due after ten years                       | 5,000                         | 4,880         | 1,177                       | 1,179         |
| Mortgage-backed securities                | 174,905                       | 174,579       | 98,102                      | 98,030        |
| Total debt securities                     | 247,406                       | 247,013       | 148,485                     | 151,684       |
| Equity securities                         | 83                            | 127           | —                           | —             |
| Total securities                          | \$ 247,489                    | 247,140       | 148,485                     | 151,684       |



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At March 31, 2016 and December 31, 2015 investment securities with carrying values of \$158,504,000 and \$141,379,000, respectively, were pledged as collateral for public deposits.

In the first quarter of 2016, the Company received proceeds from sales of securities of \$8,000 and recorded \$3,000 in gains from the sales. The Company recorded no gains or losses on securities during the three month period ended March 31, 2015.

The aggregate carrying amount of cost-method investments was \$16,031,000 and \$5,871,000 at March 31, 2016 and 2015, 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 \$8,975,000 and \$5,871,000 at March 31, 2016 and 2015, 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 \$7,056,000 at March 31, 2016. 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.

Note 7 – 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 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 April 1, 2016, one of the Company's loss share agreements with the FDIC expired. The agreement that expired related to the non-single family assets of The Bank of Asheville, a failed bank acquisition from January 2011. Accordingly, the remaining balances associated with these loans and foreclosed real estate were transferred from the covered portfolio to the non-covered portfolio on April 1, 2016. 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 \$17.7 million and the foreclosed real estate in this portfolio had a carrying value of \$1.2 million. Of the \$17.7 million in loans that lost loss share protection, approximately \$2.8 million were on nonaccrual status as of April 1, 2016. Additionally, approximately \$0.3 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 April 1, 2016.



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

| (\$ in thousands)                                                 | March 31, 2016 |            | December 31, 2015 |            | March 31, 2015 |            |
|-------------------------------------------------------------------|----------------|------------|-------------------|------------|----------------|------------|
|                                                                   | Amount         | Percentage | Amount            | Percentage | Amount         | Percentage |
| <u>All loans (non-covered and covered):</u>                       |                |            |                   |            |                |            |
| Commercial, financial, and agricultural                           | \$228,867      | 9%         | \$202,671         | 8%         | \$176,013      | 7%         |
| Real estate – construction, land development & other land loans   | 302,052        | 12%        | 308,969           | 12%        | 285,319        | 12%        |
| Real estate – mortgage – residential (1-4 family) first mortgages | 757,696        | 30%        | 768,559           | 31%        | 776,313        | 33%        |
| Real estate – mortgage – home equity loans / lines of credit      | 235,380        | 9%         | 232,601           | 9%         | 223,679        | 9%         |
| Real estate – mortgage – commercial and other                     | 966,937        | 38%        | 957,587           | 38%        | 885,282        | 37%        |
| Installment loans to individuals                                  | 47,163         | 2%         | 47,666            | 2%         | 48,010         | 2%         |
| Subtotal                                                          | 2,538,095      | 100%       | 2,518,053         | 100%       | 2,394,616      | 100%       |
| Unamortized net deferred loan costs                               | 1,258          |            | 873               |            | 783            |            |
| Total loans                                                       | \$2,539,353    |            | \$2,518,926       |            | \$2,395,399    |            |

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

| (\$ in thousands)                                                 | March 31, 2016 |            | December 31, 2015 |            | March 31, 2015 |            |
|-------------------------------------------------------------------|----------------|------------|-------------------|------------|----------------|------------|
|                                                                   | Amount         | Percentage | Amount            | Percentage | Amount         | Percentage |
| Non-covered loans:                                                |                |            |                   |            |                |            |
| Commercial, financial, and agricultural                           | \$228,124      | 10%        | \$201,798         | 8%         | \$174,516      | 8%         |
| Real estate – construction, land development & other land loans   | 298,410        | 12%        | 305,228           | 13%        | 279,780        | 12%        |
| Real estate – mortgage – residential (1-4 family) first mortgages | 684,085        | 28%        | 692,902           | 29%        | 690,910        | 31%        |
| Real estate – mortgage – home equity loans / lines of credit      | 225,245        | 9%         | 221,995           | 9%         | 211,337        | 9%         |
| Real estate – mortgage – commercial and other                     | 955,550        | 39%        | 945,823           | 39%        | 870,234        | 38%        |
| Installment loans to individuals                                  | 47,158         | 2%         | 47,666            | 2%         | 48,010         | 2%         |
| Subtotal                                                          | 2,438,572      | 100%       | 2,415,412         | 100%       | 2,274,787      | 100%       |
| Unamortized net deferred loan costs                               | 1,258          |            | 873               |            | 783            |            |
| Total non-covered loans                                           | \$2,439,830    |            | \$2,416,285       |            | \$2,275,570    |            |

The carrying amount of the covered loans at March 31, 2016 consisted of impaired and nonimpaired purchased loans (as determined on the date of acquisition), as follows:

| Impaired<br>Purchased | Impaired<br>Purchased | Nonimpaired<br>Purchased | Nonimpaired<br>Purchased | Total<br>Covered | Total<br>Covered |
|-----------------------|-----------------------|--------------------------|--------------------------|------------------|------------------|
|-----------------------|-----------------------|--------------------------|--------------------------|------------------|------------------|

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(\$ in thousands)

| Loans –<br>Carrying–<br>Value | Loans<br>Unpaid<br>Principal<br>Balance | Loans –<br>Carrying<br>Value | Loans -<br>Unpaid<br>Principal<br>Balance | Loans –<br>Carrying<br>Value | Loans –<br>Unpaid<br>Principal<br>Balance |
|-------------------------------|-----------------------------------------|------------------------------|-------------------------------------------|------------------------------|-------------------------------------------|
|-------------------------------|-----------------------------------------|------------------------------|-------------------------------------------|------------------------------|-------------------------------------------|

Covered loans:

|                                                                   |         |       |        |         |        |         |
|-------------------------------------------------------------------|---------|-------|--------|---------|--------|---------|
| Commercial, financial, and agricultural                           | \$—     | —     | 743    | 748     | 743    | 748     |
| Real estate – construction, land development & other land loans   | 207     | 332   | 3,435  | 3,384   | 3,642  | 3,716   |
| Real estate – mortgage – residential (1-4 family) first mortgages | 80      | 564   | 73,531 | 85,962  | 73,611 | 86,526  |
| Real estate – mortgage – home equity loans / lines of credit      | 7       | 14    | 10,128 | 11,516  | 10,135 | 11,530  |
| Real estate – mortgage – commercial and other                     | 873     | 1,973 | 10,514 | 11,105  | 11,387 | 13,078  |
| Installment loans to individuals                                  | —       | —     | 5      | 35      | 5      | 35      |
| Total                                                             | \$1,167 | 2,883 | 98,356 | 112,750 | 99,523 | 115,633 |

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

|                                                                   | Impaired<br>Purchased<br>Loans –<br>Carrying<br>Value | Impaired<br>Purchased<br>Loans –<br>Unpaid<br>Principal<br>Balance | Nonimpaired<br>Purchased<br>Loans –<br>Carrying<br>Value | Nonimpaired<br>Purchased<br>Loans –<br>Unpaid<br>Principal<br>Balance | Total<br>Covered<br>Loans –<br>Carrying<br>Value | Total<br>Covered<br>Loans –<br>Unpaid<br>Principal<br>Balance |
|-------------------------------------------------------------------|-------------------------------------------------------|--------------------------------------------------------------------|----------------------------------------------------------|-----------------------------------------------------------------------|--------------------------------------------------|---------------------------------------------------------------|
| (\$ in thousands)                                                 |                                                       |                                                                    |                                                          |                                                                       |                                                  |                                                               |
| 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 following table presents information regarding covered purchased nonimpaired loans since December 31, 2014. 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, 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   |
| Principal repayments                                              | (3,975 )  |
| Transfers to foreclosed real estate                               | (869 )    |
| Net loan (charge-offs) / recoveries                               | 893       |
| Accretion of loan discount                                        | 1,055     |
| Carrying amount of nonimpaired covered loans at March 31, 2016    | \$98,356  |

As reflected in the table above, the Company accreted \$1,055,000 of the loan discount on purchased nonimpaired loans into interest income during the first quarter of 2016. As of March 31, 2016, there was remaining loan discount of \$12,489,000 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 March 31, 2016, the Company also had \$1,546,000 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.

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The following table presents information regarding all purchased impaired loans since December 31, 2014, 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.

(\$ in thousands)

|                                    | Contractual<br>Principal<br>Receivable | Fair Market<br>Value<br>Adjustment –<br>Write Down<br>(Nonaccretable<br>Difference) | Carrying<br>Amount |
|------------------------------------|----------------------------------------|-------------------------------------------------------------------------------------|--------------------|
| <b>Purchased Impaired Loans</b>    |                                        |                                                                                     |                    |
| 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              |
| Change due to payments received    | (879 )                                 | (711 )                                                                              | (168 )             |
| Change due to loan charge-off      | (394 )                                 | (324 )                                                                              | (70 )              |
| Balance at March 31, 2016          | \$ 3,518                               | 1,786                                                                               | 1,732              |

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 the first quarter of 2016 and 2015, the Company received \$69,000 and \$0, respectively, in payments that exceeded the initial carrying amount of the purchased impaired loans, which is included in interest income.

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:

|                                             | March 31,<br>2016 | December 31,<br>2015 | March 31,<br>2015 |
|---------------------------------------------|-------------------|----------------------|-------------------|
| <b>ASSET QUALITY DATA</b> (\$ in thousands) |                   |                      |                   |

Non-covered nonperforming assets

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|                                        |           |           |            |
|----------------------------------------|-----------|-----------|------------|
| Nonaccrual loans                       | \$ 35,741 | \$ 39,994 | \$ 47,416  |
| Restructured loans - accruing          | 27,055    | 28,011    | 33,997     |
| Accruing loans > 90 days past due      | —         | —         | —          |
| Total non-covered nonperforming loans  | 62,796    | 68,005    | 81,413     |
| Foreclosed real estate                 | 8,767     | 9,188     | 8,978      |
| Total non-covered nonperforming assets | \$ 71,563 | \$ 77,193 | \$ 90,391  |
|                                        |           |           |            |
| Covered nonperforming assets           |           |           |            |
| Nonaccrual loans (1)                   | \$ 5,670  | \$ 7,816  | \$ 8,596   |
| Restructured loans - accruing          | 3,459     | 3,478     | 3,874      |
| Accruing loans > 90 days past due      | —         | —         | —          |
| Total covered nonperforming loans      | 9,129     | 11,294    | 12,470     |
| Foreclosed real estate                 | 1,569     | 806       | 2,055      |
| Total covered nonperforming assets     | \$ 10,698 | \$ 12,100 | \$ 14,525  |
|                                        |           |           |            |
| Total nonperforming assets             | \$ 82,261 | \$ 89,293 | \$ 104,916 |

(1) At March 31, 2016, December 31, 2015, and March 31, 2015, the contractual balance of the nonaccrual loans covered by FDIC loss share agreements was \$9.0 million, \$12.3 million, and \$14.1 million, respectively.

At March 31, 2016, the Company had \$2.1 million in residential mortgage loans in process of foreclosure.



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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.

The following table presents the Company's nonaccrual loans as of March 31, 2016.

| (\$ in thousands)                                               | Non-covered | Covered | Total  |
|-----------------------------------------------------------------|-------------|---------|--------|
| Commercial, financial, and agricultural:                        |             |         |        |
| Commercial – unsecured                                          | \$ 443      | 22      | 465    |
| Commercial – secured                                            | 2,113       | —       | 2,113  |
| Secured by inventory and accounts receivable                    | 84          | —       | 84     |
| Real estate – construction, land development & other land loans | 3,950       | —       | 3,950  |
| Real estate – residential, farmland and multi-family            | 20,137      | 3,262   | 23,399 |
| Real estate – home equity lines of credit                       | 1,821       | 329     | 2,150  |
| Real estate – commercial                                        | 7,086       | 2,057   | 9,143  |
| Consumer                                                        | 107         | —       | 107    |
| Total                                                           | \$ 35,741   | 5,670   | 41,411 |

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 |
|-------|-----------|-------|--------|

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The following table presents an analysis of the payment status of the Company's loans as of March 31, 2016.

| (\$ 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                                          | \$3                          | —                            | 443                 | 77,581    | 78,027                       |
| Commercial - secured                                            | 579                          | —                            | 2,113               | 113,605   | 116,297                      |
| Secured by inventory and accounts receivable                    | 19                           | —                            | 84                  | 40,083    | 40,186                       |
| Real estate – construction, land development & other land loans | 1,211                        | 118                          | 3,950               | 275,585   | 280,864                      |
| Real estate – residential, farmland, and multi-family           | 9,837                        | 1,824                        | 20,137              | 810,797   | 842,595                      |
| Real estate – home equity lines of credit                       | 1,043                        | 76                           | 1,821               | 212,030   | 214,970                      |
| Real estate - commercial                                        | 1,301                        | 659                          | 7,086               | 815,813   | 824,859                      |
| Consumer                                                        | 226                          | 131                          | 107                 | 40,310    | 40,774                       |
| Total non-covered                                               | \$14,219                     | 2,808                        | 35,741              | 2,385,804 | 2,438,572                    |
| Unamortized net deferred loan costs                             |                              |                              |                     |           | 1,258                        |
| Total non-covered loans                                         |                              |                              |                     |           | \$2,439,830                  |
| Covered loans                                                   | \$5,173                      | 5                            | 5,670               | 88,675    | 99,523                       |
| Total loans                                                     | \$19,392                     | 2,813                        | 41,411              | 2,474,479 | 2,539,353                    |

The Company had no non-covered or covered loans that were past due greater than 90 days and accruing interest at March 31, 2016.

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                      |

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|                                                                 |          |       |        |           |             |
|-----------------------------------------------------------------|----------|-------|--------|-----------|-------------|
| 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.

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The following table presents the activity in the allowance for loan losses for non-covered loans for the three months ended March 31, 2016.

| (\$ in thousands)                                               | Commercial,<br>Financial,<br>and<br>Agricultural<br>Loans | 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 three months ended March 31, 2016             |                                                           |                                                                                        |                                                                         |                                                          |                                                |          |                  |           |
| Beginning balance                                               | \$4,758                                                   | 3,410                                                                                  | 9,154                                                                   | 2,741                                                    | 4,987                                          | 1,038    | 696              | 26,704    |
| Charge-offs                                                     | (533 )                                                    | (259 )                                                                                 | (2,014 )                                                                | (466 )                                                   | (166 )                                         | (425 )   | —                | (3,863 )  |
| Recoveries                                                      | 79                                                        | 85                                                                                     | 315                                                                     | 13                                                       | 96                                             | 119      | —                | 707       |
| Provisions                                                      | 612                                                       | (229 )                                                                                 | 1,291                                                                   | (285 )                                                   | 252                                            | 234      | (254 )           | 1,621     |
| Ending balance                                                  | \$4,916                                                   | 3,007                                                                                  | 8,746                                                                   | 2,003                                                    | 5,169                                          | 966      | 442              | 25,189    |
| Ending balances as of March 31, 2016: Allowance for loan losses |                                                           |                                                                                        |                                                                         |                                                          |                                                |          |                  |           |
| Individually evaluated for impairment                           | \$118                                                     | 183                                                                                    | 1,427                                                                   | —                                                        | 554                                            | —        | —                | 2,282     |
| Collectively evaluated for impairment                           | \$4,798                                                   | 2,824                                                                                  | 7,319                                                                   | 2,003                                                    | 4,615                                          | 966      | 442              | 22,907    |
| Loans acquired with deteriorated credit quality                 | \$—                                                       | —                                                                                      | —                                                                       | —                                                        | —                                              | —        | —                | —         |
| Loans receivable as of March 31, 2016:                          |                                                           |                                                                                        |                                                                         |                                                          |                                                |          |                  |           |
| Ending balance – total                                          | \$234,510                                                 | 280,864                                                                                | 842,595                                                                 | 214,970                                                  | 824,859                                        | 40,774   | —                | 2,400,572 |
| Unamortized net deferred loan costs                             | —                                                         | —                                                                                      | —                                                                       | —                                                        | —                                              | —        | —                | 1,234     |
| Total non-covered loans                                         | —                                                         | —                                                                                      | —                                                                       | —                                                        | —                                              | —        | —                | 2,401,806 |
| Ending balances as of March 31, 2016: Loans                     |                                                           |                                                                                        |                                                                         |                                                          |                                                |          |                  |           |
| Individually evaluated for impairment                           | \$923                                                     | 4,393                                                                                  | 22,658                                                                  | 13                                                       | 13,467                                         | —        | —                | 41,454    |
| Collectively evaluated for impairment                           | \$233,587                                                 | 276,471                                                                                | 819,937                                                                 | 214,957                                                  | 810,828                                        | 40,774   | —                | 2,386,774 |
| Loans acquired with deteriorated credit quality                 | \$—                                                       | —                                                                                      | —                                                                       | —                                                        | 564                                            | —        | —                | 564       |

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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-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 ) | —   | (17,115 ) |
| Recoveries        | 876      | 993      | 321      | 100    | 888      | 368      | —   | 3,546     |
| Provisions        | (825 )   | (1,406 ) | 4,795    | (264 ) | (2,307 ) | 1,466    | 549 | 2,000     |
| Ending balance    | \$4,758  | 3,410    | 9,154    | 2,741  | 4,987    | 1,038    | 696 | 26,742    |

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 | 24,055 |
| 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 | — | 2,415,312 |
| Unamortized net deferred loan costs |           |         |         |         |         |        |   | 873       |
| Total non-covered loans             |           |         |         |         |         |        |   | 2,416,185 |

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 three months ended March 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 three months ended March 31, 2015

|                   |          |          |          |       |          |        |     |       |
|-------------------|----------|----------|----------|-------|----------|--------|-----|-------|
| Beginning balance | \$8,391  | 6,470    | 9,720    | 3,731 | 9,045    | 841    | 147 | 38,3  |
| Charge-offs       | (944 )   | (1,256 ) | (1,569 ) | (67 ) | (923 )   | (601 ) | —   | (5,36 |
| Recoveries        | 88       | 267      | 16       | 17    | 202      | 91     | —   | 681   |
| Provisions        | (1,778 ) | 525      | 2,659    | 482   | (2,405 ) | 464    | 157 | 104   |
| Ending balance    | \$5,757  | 6,006    | 10,826   | 4,163 | 5,919    | 795    | 304 | 33,7  |

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

|                                                 |         |       |       |       |       |     |     |      |
|-------------------------------------------------|---------|-------|-------|-------|-------|-----|-----|------|
| Individually evaluated for impairment           | \$131   | 415   | 1,690 | —     | 505   | —   | —   | 2,74 |
| Collectively evaluated for impairment           | \$5,626 | 5,591 | 9,136 | 4,163 | 5,414 | 795 | 304 | 31,0 |
| Loans acquired with deteriorated credit quality | \$—     | —     | —     | —     | —     | —   | —   | —    |

Loans receivable as of March 31, 2015:

|                                     |           |         |         |         |         |        |   |      |
|-------------------------------------|-----------|---------|---------|---------|---------|--------|---|------|
| Ending balance – total              | \$181,921 | 256,851 | 838,651 | 199,176 | 757,018 | 41,170 | — | 2,27 |
| Unamortized net deferred loan costs |           |         |         |         |         |        |   | 783  |
| Total non-covered loans             |           |         |         |         |         |        |   | 2,27 |

Ending balances as of March 31, 2015: Loans

|                                                 |           |         |         |         |         |        |   |      |
|-------------------------------------------------|-----------|---------|---------|---------|---------|--------|---|------|
| Individually evaluated for impairment           | \$800     | 6,720   | 23,527  | —       | 20,504  | —      | — | 51,5 |
| Collectively evaluated for impairment           | \$181,121 | 250,131 | 815,124 | 199,176 | 735,883 | 41,170 | — | 2,22 |
| Loans acquired with deteriorated credit quality | \$—       | —       | —       | —       | 631     | —      | — | 631  |



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The following table presents the activity in the allowance for loan losses for covered loans for the three months ended March 31, 2016.

| (\$ in thousands)                                   | Covered Loans |
|-----------------------------------------------------|---------------|
| As of and for the three months ended March 31, 2016 |               |
| Beginning balance                                   | \$ 1,799      |
| Charge-offs                                         | (241 )        |
| Recoveries                                          | 1,204         |
| Provision (reversal) for loan losses                | (1,363 )      |
| Ending balance                                      | \$ 1,399      |

Ending balances as of March 31, 2016: Allowance for loan losses

|                                                 |        |
|-------------------------------------------------|--------|
| Individually evaluated for impairment           | \$ 438 |
| Collectively evaluated for impairment           | 961    |
| Loans acquired with deteriorated credit quality | —      |

Loans receivable as of March 31, 2016:

|                        |           |
|------------------------|-----------|
| Ending balance – total | \$ 99,523 |
|------------------------|-----------|

Ending balances as of March 31, 2016: Loans

|                                                 |          |
|-------------------------------------------------|----------|
| Individually evaluated for impairment           | \$ 5,105 |
| Collectively evaluated for impairment           | 93,250   |
| Loans acquired with deteriorated credit quality | 1,168    |

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    |

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The following table presents the activity in the allowance for loan losses for covered loans for the three months ended March 31, 2015.

| (\$ in thousands)                                   | Covered Loans |
|-----------------------------------------------------|---------------|
| As of and for the three months ended March 31, 2015 |               |
| Beginning balance                                   | \$ 2,281      |
| Charge-offs                                         | (440 )        |
| Recoveries                                          | 653           |
| Provisions (reversal) for loan losses               | (268 )        |
| Ending balance                                      | \$ 2,226      |

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

|                                                 |          |
|-------------------------------------------------|----------|
| Individually evaluated for impairment           | \$ 1,058 |
| Collectively evaluated for impairment           | 1,144    |
| Loans acquired with deteriorated credit quality | 24       |

Loans receivable as of March 31, 2015:

|                        |            |
|------------------------|------------|
| Ending balance – total | \$ 119,829 |
|------------------------|------------|

Ending balances as of March 31, 2015: Loans

|                                                 |          |
|-------------------------------------------------|----------|
| Individually evaluated for impairment           | \$ 7,868 |
| Collectively evaluated for impairment           | 110,099  |
| Loans acquired with deteriorated credit quality | 1,862    |

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The following table presents loans individually evaluated for impairment by class of loans as of March 31, 2016.

| <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                                          | \$ 195                 | 227                            | —                    | 214                               |
| Commercial - secured                                            | 494                    | 545                            | —                    | 311                               |
| Secured by inventory and accounts receivable                    | —                      | —                              | —                    | —                                 |
| Real estate – construction, land development & other land loans | 3,858                  | 7,422                          | —                    | 3,890                             |
| Real estate – residential, farmland, and multi-family           | 8,943                  | 10,289                         | —                    | 9,683                             |
| Real estate – home equity lines of credit                       | 13                     | 16                             | —                    | 7                                 |
| Real estate – commercial                                        | 8,350                  | 9,077                          | —                    | 9,171                             |
| Consumer                                                        | —                      | —                              | —                    | —                                 |
| Total non-covered impaired loans with no allowance              | \$ 21,853              | 27,576                         | —                    | 23,276                            |
| Total covered impaired loans with no allowance                  | \$ 3,743               | 6,363                          | —                    | 4,487                             |
| Total impaired loans with no allowance recorded                 | \$ 25,596              | 33,936                         | —                    | 27,763                            |
| Non-covered loans with an allowance recorded:                   |                        |                                |                      |                                   |
| Commercial, financial, and agricultural:                        |                        |                                |                      |                                   |
| Commercial - unsecured                                          | \$ 202                 | 223                            | 112                  | 165                               |
| Commercial - secured                                            | 32                     | 32                             | 6                    | 224                               |
| Secured by inventory and accounts receivable                    | —                      | —                              | —                    | —                                 |
| Real estate – construction, land development & other land loans | 535                    | 541                            | 183                  | 584                               |
| Real estate – residential, farmland, and multi-family           | 13,715                 | 14,347                         | 1,427                | 13,566                            |
| Real estate – home equity lines of credit                       | —                      | —                              | —                    | 188                               |
| Real estate – commercial                                        | 5,681                  | 6,170                          | 554                  | 5,544                             |
| Consumer                                                        | —                      | —                              | —                    | 80                                |
| Total non-covered impaired loans with allowance                 | \$ 20,165              | 21,313                         | 2,282                | 20,351                            |
| Total covered impaired loans with allowance                     | \$ 2,530               | 2,692                          | 438                  | 2,872                             |
| Total impaired loans with an allowance recorded                 | \$ 22,695              | 24,005                         | 2,720                | 23,223                            |

Interest income recorded on non-covered and covered impaired loans during the three months ended March 31, 2016 was insignificant.

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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 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 March 31, 2016.

| (\$ in thousands)                                               | Credit Quality Indicator (Grouped by Internally Assigned Grades) |                                               |                                                  |                                             |                                                 |                      |
|-----------------------------------------------------------------|------------------------------------------------------------------|-----------------------------------------------|--------------------------------------------------|---------------------------------------------|-------------------------------------------------|----------------------|
|                                                                 | Pass<br>(Grades<br>1, 2,<br>& 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                                          | \$51,823                                                         | 23,955                                        | 47                                               | 1,069                                       | 690                                             | 443                  |
| Commercial - secured                                            | 58,192                                                           | 52,083                                        | 32                                               | 2,234                                       | 1,643                                           | 2,113                |
| Secured by inventory and accounts receivable                    | 18,743                                                           | 20,565                                        | —                                                | 233                                         | 561                                             | 84                   |
| Real estate – construction, land development & other land loans | 100,984                                                          | 156,482                                       | 560                                              | 10,633                                      | 8,255                                           | 3,950                |
| Real estate – residential, farmland, and multi-family           | 214,520                                                          | 529,934                                       | 3,910                                            | 42,657                                      | 31,437                                          | 20,137               |
| Real estate – home equity lines of credit                       | 134,515                                                          | 68,243                                        | 1,537                                            | 5,140                                       | 3,714                                           | 1,821                |
| Real estate - commercial                                        | 288,882                                                          | 483,699                                       | 7,120                                            | 25,116                                      | 12,956                                          | 7,086                |
| Consumer                                                        | 26,347                                                           | 13,451                                        | 4                                                | 656                                         | 209                                             | 107                  |
| Total                                                           | \$894,006                                                        | 1,348,412                                     | 13,210                                           | 87,738                                      | 59,465                                          | 35,741               |
| Unamortized net deferred loan costs                             |                                                                  |                                               |                                                  |                                             |                                                 |                      |
| Total non-covered loans                                         |                                                                  |                                               |                                                  |                                             |                                                 |                      |
| Total covered loans                                             | \$12,035                                                         | 57,128                                        | 248                                              | 7,251                                       | 17,191                                          | 5,670                |
| Total loans                                                     | \$906,041                                                        | 1,405,540                                     | 13,458                                           | 94,989                                      | 76,656                                          | 41,411               |

At March 31, 2016, 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, 2015.

| (\$ in thousands)                                               | Credit Quality Indicator (Grouped by Internally Assigned Grades) |                                               |                                                  |                                             |                                                 |                      |
|-----------------------------------------------------------------|------------------------------------------------------------------|-----------------------------------------------|--------------------------------------------------|---------------------------------------------|-------------------------------------------------|----------------------|
|                                                                 | Pass<br>(Grades<br>1, 2,<br>& 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.

*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 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 three months ended March 31, 2016 and 2015.

| (\$ in thousands)                                               | For the three months ended March 31, 2016 |                                           |                                            | For the three months ended March 31, 2015 |                                           |                                            |
|-----------------------------------------------------------------|-------------------------------------------|-------------------------------------------|--------------------------------------------|-------------------------------------------|-------------------------------------------|--------------------------------------------|
|                                                                 | Number of Contracts                       | Pre-Modification of Restructured Balances | Post-Modification of Restructured Balances | Number of Contracts                       | Pre-Modification of Restructured Balances | Post-Modification of Restructured Balances |
| Non-covered TDRs – Accruing                                     |                                           |                                           |                                            |                                           |                                           |                                            |
| Commercial, financial, and agricultural:                        |                                           |                                           |                                            |                                           |                                           |                                            |
| Commercial – unsecured                                          | —                                         | \$ —                                      | \$ —                                       | —                                         | \$ —                                      | \$ —                                       |
| Commercial – secured                                            | —                                         | —                                         | —                                          | —                                         | —                                         | —                                          |
| Secured by inventory and accounts receivable                    | —                                         | —                                         | —                                          | —                                         | —                                         | —                                          |
| Real estate – construction, land development & other land loans | —                                         | —                                         | —                                          | —                                         | —                                         | —                                          |
| Real estate – residential, farmland, and multi-family           | —                                         | —                                         | —                                          | 1                                         | 113                                       | 113                                        |
| Real estate – home equity lines of credit                       | —                                         | —                                         | —                                          | —                                         | —                                         | —                                          |
| Real estate – commercial                                        | —                                         | —                                         | —                                          | 1                                         | 51                                        | 51                                         |
| Consumer                                                        | —                                         | —                                         | —                                          | —                                         | —                                         | —                                          |
| Non-covered TDRs – Nonaccrual                                   |                                           |                                           |                                            |                                           |                                           |                                            |
| Commercial, financial, and agricultural:                        |                                           |                                           |                                            |                                           |                                           |                                            |
| Commercial – unsecured                                          | —                                         | —                                         | —                                          | —                                         | —                                         | —                                          |
| Commercial – secured                                            | —                                         | —                                         | —                                          | —                                         | —                                         | —                                          |
| Secured by inventory and accounts receivable                    | —                                         | —                                         | —                                          | —                                         | —                                         | —                                          |
| Real estate – construction, land development & other land loans | —                                         | —                                         | —                                          | —                                         | —                                         | —                                          |
| Real estate – residential, farmland, and multi-family           | —                                         | —                                         | —                                          | 4                                         | 305                                       | 305                                        |
| Real estate – home equity lines of credit                       | —                                         | —                                         | —                                          | —                                         | —                                         | —                                          |
| Real estate – commercial                                        | —                                         | —                                         | —                                          | —                                         | —                                         | —                                          |
| Consumer                                                        | —                                         | —                                         | —                                          | —                                         | —                                         | —                                          |
| Total non-covered TDRs arising during period                    | —                                         | —                                         | —                                          | 6                                         | 469                                       | 469                                        |
| Total covered TDRs arising during period– Accruing              | —                                         | \$ —                                      | \$ —                                       | 2                                         | \$ 139                                    | \$ 139                                     |
| Total covered TDRs arising during period – Nonaccrual           | —                                         | —                                         | —                                          | —                                         | —                                         | —                                          |
| Total TDRs arising during period                                | —                                         | \$ —                                      | \$ —                                       | 8                                         | \$ 608                                    | \$ 608                                     |

Accruing restructured loans that were modified in the previous 12 months and that defaulted during the three months ended March 31, 2016 and 2015 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.

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| (\$ in thousands)                                       | For the three months ended<br>March 31, 2016 |                        | For the three months ended<br>March 31, 2015 |                        |
|---------------------------------------------------------|----------------------------------------------|------------------------|----------------------------------------------|------------------------|
|                                                         | Number<br>of<br>Contracts                    | Recorded<br>Investment | Number<br>of<br>Contracts                    | Recorded<br>Investment |
| Non-covered accruing TDRs that subsequently defaulted   |                                              |                        |                                              |                        |
| Real estate – residential, farmland, and multi-family   | 1                                            | \$ 21                  | 1                                            | \$ 34                  |
| Total non-covered TDRs that subsequently defaulted      | 1                                            | \$ 21                  | 1                                            | \$ 34                  |
| Total accruing covered TDRs that subsequently defaulted | 1                                            | \$ 44                  | —                                            | \$ —                   |
| Total accruing TDRs that subsequently defaulted         | 2                                            | \$ 65                  | 1                                            | \$ 34                  |

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## Note 8 – Deferred Loan Costs

The amount of loans shown on the Consolidated Balance Sheets includes net deferred loan costs of approximately \$1,258,000, \$873,000, and \$783,000 at March 31, 2016, December 31, 2015, and March 31, 2015, respectively.

## Note 9 – FDIC Indemnification Asset

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 page 42 of the Company's 2015 Annual Report on Form 10-K for a detailed explanation of this asset.

The FDIC indemnification asset was comprised of the following components as of the dates shown:

| (\$ in thousands)                                                                               | March<br>31,<br>2016 | December<br>31,<br>2015 | March<br>31,<br>2015 |
|-------------------------------------------------------------------------------------------------|----------------------|-------------------------|----------------------|
| Receivable (payable) related to loss claims incurred (recoveries), not yet received (paid), net | \$(1,143)            | (633 )                  | 4,884                |
| Receivable related to estimated future claims on loans                                          | 7,422                | 8,675                   | 12,886               |
| Receivable related to estimated future claims on foreclosed real estate                         | 425                  | 397                     | 682                  |
| FDIC indemnification asset                                                                      | \$6,704              | 8,439                   | 18,452               |

Included in the receivable related to loss claims incurred, not yet reimbursed, at March 31, 2015, 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.

The following presents a rollforward of the FDIC indemnification asset since December 31, 2015.

(\$ in thousands)

|                                                         |         |
|---------------------------------------------------------|---------|
| Balance at December 31, 2015                            | \$8,439 |
| Decrease related to favorable changes in loss estimates | (1,230) |
| Increase related to reimbursable expenses               | 99      |
| Cash paid (received)                                    | 356     |
| Related to accretion of loan discount                   | (965 )  |
| Other                                                   | 5       |
| Balance at March 31, 2016                               | \$6,704 |

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## Note 10 – Goodwill and Other Intangible Assets

The following is a summary of the gross carrying amount and accumulated amortization of amortizable intangible assets as of March 31, 2016, December 31, 2015, and March 31, 2015 and the carrying amount of unamortized intangible assets as of those same dates. In connection with the January 1, 2016 acquisition of Bankingport, Inc., an insurance agency located in Sanford, North Carolina, the Company recorded \$1,693,000 in goodwill, \$591,000 in a customer list intangible, and \$92,000 in other amortizable intangible assets.

| (\$ in thousands)                | March 31, 2016        |                          | December 31, 2015     |                          | March 31, 2015        |                          |
|----------------------------------|-----------------------|--------------------------|-----------------------|--------------------------|-----------------------|--------------------------|
|                                  | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Amortizable intangible assets:   |                       |                          |                       |                          |                       |                          |
| Customer lists                   | \$1,269               | 572                      | 678                   | 550                      | 678                   | 517                      |
| Core deposit premiums            | 8,560                 | 7,506                    | 8,560                 | 7,352                    | 8,560                 | 6,844                    |
| Other                            | 92                    | 10                       | —                     | —                        | —                     | —                        |
| Total                            | \$9,921               | 8,088                    | 9,238                 | 7,902                    | 9,238                 | 7,361                    |
| Unamortizable intangible assets: |                       |                          |                       |                          |                       |                          |
| Goodwill                         | \$67,528              |                          | 65,835                |                          | 65,835                |                          |

Amortization expense totaled \$186,000 and \$180,000 for the three months ended March 31, 2016 and 2015, respectively.

The following table presents the estimated amortization expense for the last three quarters of calendar year 2016 and for each of the four 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.

| (\$ in thousands)            | Estimated Amortization Expense |
|------------------------------|--------------------------------|
| April 1 to December 31, 2016 | \$ 553                         |
| 2017                         | 489                            |
| 2018                         | 179                            |
| 2019                         | 172                            |
| 2020                         | 76                             |
| Thereafter                   | 364                            |
| Total                        | \$ 1,833                       |



# Note 11 – Pension Plans

The Company has historically sponsored two defined benefit pension plans – a qualified retirement plan (the “Pension Plan”) which was generally available to all employees, and a Supplemental Executive Retirement Plan (the “SERP”), which was for the benefit of certain senior management executives of the Company. Effective December 31, 2012, the Company froze both plans for all participants. Although no previously accrued benefits were lost, employees no longer accrue benefits for service subsequent to 2012.

The Company recorded pension income totaling \$162,000 and \$267,000 for the three months ended March 31, 2016 and 2015, respectively, which primarily related to investment income from the Pension Plan’s assets. The following table contains the components of the pension income.

| (\$ in thousands)                     | For the Three Months Ended March 31, |                   |           |           |                       |                       |
|---------------------------------------|--------------------------------------|-------------------|-----------|-----------|-----------------------|-----------------------|
|                                       | 2016 Pension Plan                    | 2015 Pension Plan | 2016 SERP | 2015 SERP | 2016 Total Both Plans | 2015 Total Both Plans |
| Service cost                          | \$—                                  | —                 | 27        | 79        | 27                    | 79                    |
| Interest cost                         | 376                                  | 341               | 59        | 52        | 435                   | 393                   |
| Expected return on plan assets        | (675)                                | (708)             | —         | —         | (675)                 | (708)                 |
| Amortization of transition obligation | —                                    | —                 | —         | —         | —                     | —                     |
| Amortization of net (gain)/loss       | 60                                   | —                 | (9)       | (31)      | 51                    | (31)                  |
| Amortization of prior service cost    | —                                    | —                 | —         | —         | —                     | —                     |
| Net periodic pension (income)/cost    | \$(239)                              | (367)             | 77        | 100       | (162)                 | (267)                 |

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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. The contributions are invested to provide for benefits under the Pension Plan. The Company does not expect to contribute to the Pension Plan in 2016.

The Company's funding policy with respect to the SERP is to fund the related benefits from the operating cash flow of the Company.

## Note 12 – Comprehensive Income

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

(\$ in thousands)

|                                                             | March 31, 2016 | December 31, 2015 | March 31, 2015 |
|-------------------------------------------------------------|----------------|-------------------|----------------|
| Unrealized gain (loss) on securities available for sale     | \$ (349 )      | (1,163 )          | (442 )         |
| Deferred tax asset (liability)                              | 136            | 454               | 173            |
| Net unrealized gain (loss) on securities available for sale | (213 )         | (709 )            | (269 )         |
| Additional pension asset (liability)                        | (4,606 )       | (4,657 )          | (288 )         |
| Deferred tax asset (liability)                              | 1,796          | 1,816             | 112            |
| Net additional pension asset (liability)                    | (2,810 )       | (2,841 )          | (176 )         |
| Total accumulated other comprehensive income (loss)         | \$ (3,023 )    | (3,550 )          | (445 )         |

The following table discloses the changes in accumulated other comprehensive income (loss) for the three months ended March 31, 2016 (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, 2016 | \$ (709 )                                                           | (2,841 )                                      | (3,550) |

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|                                                                  |         |          |           |
|------------------------------------------------------------------|---------|----------|-----------|
| Other comprehensive income (loss) before reclassifications       | 498     | —        | 498       |
| Amounts reclassified from accumulated other comprehensive income | (2      | ) 31     | 29        |
| Net current-period other comprehensive income (loss)             | 496     | 31       | 527       |
| Ending balance at March 31, 2016                                 | \$ (213 | ) (2,810 | ) (3,023) |

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

|                                                                  |                                                                  |                                            |         |
|------------------------------------------------------------------|------------------------------------------------------------------|--------------------------------------------|---------|
| <i>(\$ in thousands)</i>                                         | Unrealized Gain<br>(Loss) on<br>Securities<br>Available for Sale | Additional<br>Pension Asset<br>(Liability) | Total   |
| Beginning balance at January 1, 2015                             | \$ (421                                                          | ) (157                                     | ) (578) |
| Other comprehensive income (loss) before reclassifications       | 152                                                              | —                                          | 152     |
| Amounts reclassified from accumulated other comprehensive income | —                                                                | (19                                        | ) (19 ) |
| Net current-period other comprehensive income (loss)             | 152                                                              | (19                                        | ) 133   |
| Ending balance at March 31, 2015                                 | \$ (269                                                          | ) (176                                     | ) (445) |

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## Note 13 – Fair Value

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.

The following table summarizes the Company's financial instruments that were measured at fair value on a recurring and nonrecurring basis at March 31, 2016.

(\$ in thousands)

| Description of Financial Instruments       | Fair Value at March 31, 2016 | 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 | \$38,636                     | —                                                              | 38,636                                        | —                                         |
| Mortgage-backed securities                 | 174,579                      | —                                                              | 174,579                                       | —                                         |
| Corporate bonds                            | 33,798                       | —                                                              | 33,798                                        | —                                         |
| Equity securities                          | 127                          | —                                                              | 127                                           | —                                         |
| Total available for sale securities        | \$247,140                    | —                                                              | 247,140                                       | —                                         |
| <b>Nonrecurring</b>                        |                              |                                                                |                                               |                                           |
| Impaired loans – covered                   | \$2,093                      | —                                                              | —                                             | 2,093                                     |
| Impaired loans – non-covered               | 18,478                       | —                                                              | —                                             | 18,478                                    |

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|                                      |       |   |   |       |
|--------------------------------------|-------|---|---|-------|
| Foreclosed real estate – covered     | 1,569 | — | — | 1,569 |
| Foreclosed real estate – non-covered | 8,767 | — | — | 8,767 |

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                                     |

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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.

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.



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For Level 3 assets and liabilities measured at fair value on a recurring or non-recurring basis as of March 31, 2016, the significant unobservable inputs used in the fair value measurements were as follows:

| (\$ in thousands)                    |                              |                                            |                                                                                                        |                                                        |
|--------------------------------------|------------------------------|--------------------------------------------|--------------------------------------------------------------------------------------------------------|--------------------------------------------------------|
| Description                          | Fair Value at March 31, 2016 | Valuation Technique                        | Significant Unobservable Inputs                                                                        | General Range of Significant Unobservable Input Values |
| Impaired loans – covered             | \$ 2,093                     | 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         | 18,478                       | 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     | 1,569                        | Appraised value; List or contract price    | Discounts to reflect current market conditions and estimated costs to sell                             | 0-10%                                                  |
| Foreclosed real estate – non-covered | 8,767                        | Appraised value; List or contract price    | Discounts to reflect current market conditions, abbreviated holding period and estimated costs to sell | 0-10%                                                  |

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 estimated costs to sell | 0-10%                                                  |
| Foreclosed real estate – covered | 806                             | Appraised value; List or contract price    | Discounts to reflect current market conditions and estimated costs to sell                           | 0-10%                                                  |



|                                      |       |                                         |                                                                                                        |       |
|--------------------------------------|-------|-----------------------------------------|--------------------------------------------------------------------------------------------------------|-------|
| Foreclosed real estate – non-covered | 9,188 | 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 three months ended March 31, 2016 or 2015.

For the three months ended March 31, 2016 and 2015, the increase in the fair value of securities available for sale was \$817,000 and \$247,000, respectively, which is included in other comprehensive income (net of tax expense of \$319,000 and \$95,000, respectively). Fair value measurement methods at March 31, 2016 and 2015 are consistent with those used in prior reporting periods.

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The carrying amounts and estimated fair values of financial instruments at March 31, 2016 and December 31, 2015 are as follows:

| (\$ in thousands)                            | Level in Fair Value Hierarchy | March 31, 2016  |                      | December 31, 2015 |                      |
|----------------------------------------------|-------------------------------|-----------------|----------------------|-------------------|----------------------|
|                                              |                               | Carrying Amount | Estimated Fair Value | Carrying Amount   | Estimated Fair Value |
| Cash and due from banks, noninterest-bearing | Level 1                       | \$52,393        | 52,393               | 53,285            | 53,285               |
| Due from banks, interest-bearing             | Level 1                       | 148,734         | 148,734              | 213,426           | 213,426              |
| Federal funds sold                           | Level 1                       | 467             | 467                  | 557               | 557                  |
| Securities available for sale                | Level 2                       | 247,140         | 247,140              | 165,614           | 165,614              |
| Securities held to maturity                  | Level 2                       | 148,485         | 151,684              | 154,610           | 157,146              |
| Presold mortgages in process of settlement   | Level 1                       | 3,102           | 3,102                | 4,323             | 4,323                |
| Total loans, net of allowance                | Level 3                       | 2,512,705       | 2,493,507            | 2,490,343         | 2,484,059            |
| Accrued interest receivable                  | Level 1                       | 8,986           | 8,986                | 9,166             | 9,166                |
| FDIC indemnification asset                   | Level 3                       | 6,704           | 6,609                | 8,439             | 8,256                |
| Bank-owned life insurance                    | Level 1                       | 72,594          | 72,594               | 72,086            | 72,086               |
| Deposits                                     | Level 2                       | 2,826,821       | 2,825,909            | 2,811,285         | 2,809,828            |
| Borrowings                                   | Level 2                       | 186,394         | 178,864              | 186,394           | 178,468              |
| Accrued interest payable                     | Level 2                       | 554             | 554                  | 585               | 585                  |

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.

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

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.

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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 14 – 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 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 three months ended March 31, 2015, the Company accrued approximately \$159,000 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."

#### *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.

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The Series C Preferred Stock pays a dividend per share equal to that of the Company's common stock. During each of the first quarters of 2016 and 2015, the Company accrued approximately \$58,000 in preferred dividend payments for the Series C Preferred Stock.

Note 15 – Acquisition of Bankingport, Inc.

On January 1, 2016, the Company completed the acquisition of Bankingport, Inc. ("Bankingport"). The results of Bankingport are included in First Bancorp's results for the period ended March 31, 2016 beginning on the January 1, 2016 acquisition date.

Bankingport was an insurance agency based in Sanford, North Carolina. This acquisition represented an opportunity to expand the insurance agency operations into a contiguous and significant banking market for the Company. Also, this acquisition provided the Company with a larger platform for leveraging insurance services throughout the Company's bank branch network. The deal value was \$2.2 million and the transaction was completed on January 1, 2016 with the Company paying \$700,000 and issuing 79,012 shares of its common stock, which had a value of approximately \$1.5 million. In connection with the acquisition, the Company also paid \$1.1 million to purchase the office space previously leased by Bankingport.

This acquisition has been accounted for using the purchase method of accounting for business combinations, and accordingly, the assets and liabilities of Bankingport were recorded based on estimates of fair values as of January 1, 2016. In connection with this transaction, the Company recorded \$1.7 million in goodwill, which is non-deductible for tax purposes, and \$0.7 million in other amortizable intangible assets.

Note 16 – Pending Acquisition/Divestiture

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 in 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 all seven of its Virginia branches to First Community Bank, with total deposits of approximately \$150 million. Additionally, the exchange 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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Item 2 - Management's Discussion and Analysis of Consolidated Results of Operations and Financial Condition

**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.”

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.

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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.

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.

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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.

**FDIC Indemnification Asset**

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 page 42 of the Company’s 2015 Annual Report on Form 10-K for a detailed explanation of this asset.

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

(\$ in thousands)

|                                        | Cooperative<br>Single<br>Family<br>Loss Share<br>Loans | Bank of<br>Asheville<br>Single<br>Family Loss<br>Share Loans | Bank of<br>Asheville<br>Non-<br>Single Family<br>Loss Share<br>Loans | Total |
|----------------------------------------|--------------------------------------------------------|--------------------------------------------------------------|----------------------------------------------------------------------|-------|
| At March 31, 2016                      |                                                        |                                                              |                                                                      |       |
| Expiration of loss share agreement     | 6/30/2019                                              | 3/31/2021                                                    | 3/31/2016                                                            |       |
| Nonaccrual covered loans               |                                                        |                                                              |                                                                      |       |
| Unpaid principal balance               | \$ 3,217                                               | 693                                                          | 5,126                                                                | 9,036 |
| Carrying value prior to loan discount* | 3,068                                                  | 523                                                          | 3,626                                                                | 7,217 |
| Loan discount                          | 370                                                    | 337                                                          | 840                                                                  | 1,547 |
| Net carrying value                     | 2,698                                                  | 186                                                          | 2,786                                                                | 5,670 |
| Allowance for loan losses              | 83                                                     | 3                                                            | 44                                                                   | 130   |
| Indemnification asset recorded         | 252                                                    | 195                                                          | —                                                                    | 447   |
| All other covered loans                |                                                        |                                                              |                                                                      |       |

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|                                                                                      |        |       |        |          |
|--------------------------------------------------------------------------------------|--------|-------|--------|----------|
| Unpaid principal balance                                                             | 85,240 | 6,115 | 15,243 | 106,598  |
| Carrying value prior to loan discount*                                               | 85,073 | 6,036 | 15,232 | 106,341  |
| Loan discount                                                                        | 11,201 | 1,006 | 281    | 12,488   |
| Net carrying value                                                                   | 73,872 | 5,030 | 14,951 | 93,853   |
| Allowance for loan losses                                                            | 963    | 41    | 265    | 1,269    |
| Indemnification asset recorded                                                       | 6,257  | 729   | —      | 6,986    |
| All covered loans                                                                    |        |       |        |          |
| Unpaid principal balance                                                             | 88,457 | 6,808 | 20,369 | 115,634  |
| Carrying value prior to loan discount*                                               | 88,141 | 6,559 | 18,858 | 113,558  |
| Loan discount                                                                        | 11,571 | 1,343 | 1,121  | 14,035   |
| Net carrying value                                                                   | 76,570 | 5,216 | 17,737 | 99,523   |
| Allowance for loan losses                                                            | 1,046  | 44    | 309    | 1,399    |
| Indemnification asset recorded                                                       | 6,509  | 924   | —      | 7,433 ** |
| Foreclosed Properties                                                                |        |       |        |          |
| Net carrying value                                                                   | 404    | —     | 1,165  | 1,569    |
| Indemnification asset recorded                                                       | 393    | —     | 32     | 425      |
| For the Three Months Ended March 31, 2016                                            |        |       |        |          |
| Loan discount accretion recognized                                                   | 527    | 139   | 389    | 1,055    |
| Indemnification asset expense associated with the loan discount accretion recognized | 682    | 107   | 176    | 965      |

\* Reflects partial charge-offs

\*\* A present value adjustment of \$11 reduces the carrying value of this asset to \$7,422.

As noted in the table above, our loss share agreement related to Bank of Asheville's non-single family assets expired on March 31, 2016. On April 1, 2016, the remaining balances associated with the Bank of Asheville non-single family loans and foreclosed properties were transferred from the covered portfolio to the non-covered portfolio. Therefore, after March 31, 2016, we will bear all future losses on that portfolio of loans and foreclosed properties. At March 31, 2016, these loans and foreclosed properties were classified as covered. At March 31, 2016, the portfolio of loans had a carrying value of \$17.7 million and the portfolio of foreclosed properties had a carrying value of \$1.2 million. Of the \$17.7 million in loans that are losing loss share protection, approximately \$2.8 million of these loans were on nonaccrual status as of March 31, 2016. Additionally, approximately \$0.3 million in allowance for loan losses that related to this portfolio of loans were transferred to the allowance for loan losses for non-covered loans on April 1, 2016.

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**Current Accounting Matters**

See Note 2 to the Consolidated Financial Statements above for information about accounting standards that we have recently adopted.

**RESULTS OF OPERATIONS**

**Overview**

Net income available to common shareholders for the first quarter of 2016 amounted to \$6.8 million, or \$0.33 per diluted common share. The net income and earnings per share for the first quarter of 2016 matched those that were reported in the first quarter of 2015.

Net Interest Income and Net Interest Margin

Net interest income for the first quarter of 2016 amounted to \$30.2 million, a 1.7% increase from the \$29.7 million recorded in the first quarter of 2015. The increase was due to growth in our loans outstanding and higher yields realized on investment securities.

Our net interest margin (tax-equivalent net interest income divided by average earning assets) in the first quarter of 2016 was 4.07% compared to 4.19% for the first quarter of 2015. The lower margin was primarily due to lower loan yields, which have been impacted by the continued low interest rate environment. Additionally, we recorded a lower amount of discount accretion related to loans purchased in failed-bank acquisitions. Loan discount accretion amounted to \$1.1 million in the first quarter of 2016, compared to \$1.6 million in the first quarter of 2015. 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.

Provision for Loan Losses and Asset Quality

We recorded a total provision for loan losses of \$0.3 million in the first quarter of 2016 compared to a negative total provision for loan losses (reduction of the allowance for loan losses) of \$0.2 million in the first quarter of 2015. As discussed below, we record provisions for loan losses related to both non-covered and covered loan portfolios — see explanation of the terms “non-covered” and “covered” in the section below entitled “Note Regarding Components of Earnings.”

The provision for loan losses on non-covered loans amounted to \$1.6 million in the first quarter of 2016 compared to \$0.1 million in the first quarter of 2015. In 2015, a prolonged period of stable and improving loan quality trends resulted in a minimal amount of provision for loan losses that was needed to adjust our allowance for loan losses to the appropriate amount.

We recorded a negative provision for loan losses on covered loans (reduction of allowance for loan losses) of \$1.4 million in the first quarter of 2016 compared to a \$0.3 million negative provision for loan losses in the first quarter of 2015. The increase in the negative provision in 2016 resulted from lower levels of covered nonperforming loans, declining levels of total covered loans, and \$1.0 million in net loan recoveries (recoveries, net of charge-offs) compared to net recoveries of \$0.2 million that were realized in the first quarter of 2015.

Total non-covered nonperforming assets declined 20.8% over the past year, amounting to \$71.6 million at March 31, 2016 (2.18% of total non-covered assets) compared to \$90.4 million at March 31, 2015 (2.92% 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.

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Total covered nonperforming assets also declined over the past year, amounting to \$10.7 million at March 31, 2016 compared to \$14.5 million at March 31, 2015. Over the past twelve months, we have resolved a significant amount of covered loans and have experienced strong property sales along the North Carolina coast, which is where most of our covered assets are located.

Noninterest Income

Total noninterest income was \$5.0 million and \$4.5 million for the three months ended March 31, 2016 and March 31, 2015, respectively.

Core noninterest income for the first quarter of 2016 was \$7.3 million, an increase of 2.2% from the \$7.2 million reported for the first quarter of 2015. Core noninterest income includes i) service charges on deposit accounts, ii) other service charges, commissions, and fees, iii) fees from presold mortgages, iv) commissions from financial product sales, and v) bank-owned life insurance income. The largest increase in core noninterest income was from commissions from financial product sales, which includes property and casualty insurance commissions. Property and casualty insurance commissions increased due to the Company's January 1, 2016 acquisition of Bankingport, Inc., an insurance agency located in Sanford, North Carolina. Fees from presold mortgages declined to \$0.4 million for the first quarter of 2016 from \$0.8 million in the first quarter of 2015 as a result of fewer mortgage loan originations.

Noncore components of noninterest income resulted in a net decrease to income of \$2.3 million in the first quarter of 2016 compared to a net decrease to income of \$2.6 million in the first quarter of 2015. The largest variance in noncore noninterest income related to gains (losses) on foreclosed properties.

Noninterest Expenses

Noninterest expenses amounted to \$24.8 million in the first quarter of 2016 compared to \$23.7 million recorded in the first quarter of 2015, an increase of 4.5%.

Reported salaries expense was unchanged at \$11.5 million. A gross payroll increase of \$0.7 million in 2016 associated with our growth initiatives was offset by lower incentive compensation expense and higher salary deferrals associated with new loan originations.



Employee benefits expense was \$2.7 million in the first quarter of 2016 compared to \$2.2 million in the first quarter of 2015. This increase was primarily the result of a \$0.4 million increase in employee health insurance expense. We are self-insured for health care expense and experienced unfavorable claim levels in 2016.

Other operating expenses amounted to \$7.6 million in the first quarter of 2016 compared to \$7.0 million in the first quarter of 2015. The increase was primarily due to higher credit card and debit card fraud losses, as well as legal expenses associated with merger and acquisition activities.

#### Balance Sheet and Capital

Total assets at March 31, 2016 amounted to \$3.4 billion, a 5.1% increase from a year earlier. Total loans at March 31, 2016 amounted to \$2.5 billion, a 6.0% increase from a year earlier, and total deposits amounted to \$2.8 billion at March 31, 2016, a 4.9% increase from a year earlier.

Non-covered loans amounted to \$2.44 billion at March 31, 2016, an increase of \$164.3 million, or 7.2% from March 31, 2015, as a result of ongoing internal initiatives to drive loan growth. Loans covered by FDIC loss share agreements declined 16.9% over the past year and are expected to continue to decline as those loans continue to pay down.

The increase in total deposits at March 31, 2016 compared to March 31, 2015 was primarily due to increases in checking, money market and savings accounts, which increased in total by \$224.9 million, or 11.7%, over the past year. Those increases were partially offset by decreases in time deposits, which declined a total of \$91.6 million, or 11.9%, over the past year. Time deposits are generally one of our most expensive funding sources, and thus the shift from this category benefitted our overall cost of funds.

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We remain well-capitalized by all regulatory standards, with a Total Risk-Based Capital Ratio at March 31, 2016 of 14.45% compared to the 10.00% minimum to be considered well-capitalized. Our tangible common equity to tangible assets ratio was 8.24% at March 31, 2016, an increase of 16 basis points from a year earlier.

## Expiration of Loss-Share Agreement with the FDIC

Our loss-sharing agreement with the FDIC related to non-single family loans and foreclosed properties that were assumed in the failed bank acquisition of Bank of Asheville in 2011 expired on April 1, 2016. We will 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 or for the quarter ended March 31, 2016, which continue to be included within the “covered” line items in the accompanying tables. In the future, these assets will be included in the “non-covered” categories.

### As of March 31, 2016

|                                          |                |
|------------------------------------------|----------------|
| Loans outstanding - gross:               | \$18.9 million |
| Remaining loan discount:                 | \$1.2 million  |
| Current carrying amount:                 | \$17.7 million |
| Nonaccrual loans - carrying amount:      | \$2.8 million  |
| Troubled debt restructurings - accruing: | None           |
| Allowance for loan losses:               | \$0.3 million  |
| Remaining indemnification asset:         | None           |
| Foreclosed properties:                   | \$1.2 million  |

### For the three months ended March 31, 2016

|                                                                                              |               |
|----------------------------------------------------------------------------------------------|---------------|
| Loan discount accretion income recognized:                                                   | \$0.4 million |
| Indemnification asset expense associated with the loan discount accretion income recognized: | \$0.2 million |

We continue to have two loss-sharing agreements with the FDIC in place. The next agreement that expires does so on July 1, 2019.

## Note Regarding Components of Earnings

Our results of operation are significantly affected by the on-going accounting for two FDIC-assisted failed bank acquisitions. In the discussion above and elsewhere 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 the Company’s 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.

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Net interest income is the largest component of earnings, representing the difference between interest and fees generated from earning assets and the interest costs of deposits and other funds needed to support those assets. Net interest income for the three month period ended March 31, 2016 amounted to \$30.2 million, an increase of \$0.5 million, or 1.7%, from the \$29.7 million recorded in the first quarter of 2015. Net interest income on a tax-equivalent basis for the three month period ended March 31, 2016 amounted to \$30.7 million, an increase of \$0.6 million, or 1.9%, from the \$30.1 million recorded in the first quarter of 2015. We believe that analysis of net interest income on a tax-equivalent basis is useful and appropriate because it allows a comparison of net interest income amounts in different periods without taking into account the different mix of taxable versus non-taxable investments that may have existed during those periods.

|                                     | Three Months<br>Ended March 31, |        |
|-------------------------------------|---------------------------------|--------|
| (\$ in thousands)                   | 2016                            | 2015   |
| Net interest income, as reported    | \$30,195                        | 29,703 |
| Tax-equivalent adjustment           | 459                             | 390    |
| Net interest income, tax-equivalent | \$30,654                        | 30,093 |

There are two primary factors that cause changes in the amount of net interest income we record - 1) changes in our loans and deposits balances, and 2) our net interest margin (tax-equivalent net interest income divided by average interest-earning assets).

For the three months ended March 31, 2016, the higher net interest income compared to the same period of 2015 was due to growth in loans outstanding and higher yields realized on investment securities (see discussion below).

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The following table presents net interest income analysis on a tax-equivalent basis.

| (\$ in thousands)                                            | For the Three Months Ended March 31,<br>2016 |                 |                               | 2015              |                 |                               |
|--------------------------------------------------------------|----------------------------------------------|-----------------|-------------------------------|-------------------|-----------------|-------------------------------|
|                                                              | Average<br>Volume                            | Average<br>Rate | Interest<br>Earned<br>or Paid | Average<br>Volume | Average<br>Rate | Interest<br>Earned<br>or Paid |
| <b>Assets</b>                                                |                                              |                 |                               |                   |                 |                               |
| Loans (1)                                                    | \$2,528,317                                  | 4.70%           | \$29,573                      | \$2,391,071       | 4.99%           | \$29,441                      |
| Taxable securities                                           | 284,865                                      | 2.57%           | 1,823                         | 283,515           | 1.94%           | 1,359                         |
| Non-taxable securities (2)                                   | 51,351                                       | 7.08%           | 904                           | 53,049            | 6.52%           | 853                           |
| Short-term investments, principally federal funds            | 164,242                                      | 0.54%           | 222                           | 183,097           | 0.43%           | 195                           |
| Total interest-earning assets                                | 3,028,775                                    | 4.32%           | 32,522                        | 2,910,732         | 4.44%           | 31,848                        |
| Cash and due from banks                                      | 55,543                                       |                 |                               | 65,910            |                 |                               |
| Premises and equipment                                       | 75,710                                       |                 |                               | 75,677            |                 |                               |
| Other assets                                                 | 172,464                                      |                 |                               | 142,251           |                 |                               |
| Total assets                                                 | \$3,332,492                                  |                 |                               | \$3,194,570       |                 |                               |
| <b>Liabilities</b>                                           |                                              |                 |                               |                   |                 |                               |
| Interest bearing checking                                    | \$587,944                                    | 0.07%           | \$98                          | \$562,849         | 0.06%           | \$82                          |
| Money market deposits                                        | 650,314                                      | 0.17%           | 273                           | 557,558           | 0.12%           | 165                           |
| Savings deposits                                             | 189,889                                      | 0.05%           | 23                            | 181,154           | 0.05%           | 22                            |
| Time deposits >\$100,000                                     | 397,750                                      | 0.66%           | 652                           | 450,258           | 0.76%           | 847                           |
| Other time deposits                                          | 291,154                                      | 0.38%           | 274                           | 342,089           | 0.41%           | 342                           |
| Total interest-bearing deposits                              | 2,117,051                                    | 0.25%           | 1,320                         | 2,093,908         | 0.28%           | 1,458                         |
| Borrowings                                                   | 186,394                                      | 1.18%           | 548                           | 116,394           | 1.03%           | 297                           |
| Total interest-bearing liabilities                           | 2,303,445                                    | 0.33%           | 1,868                         | 2,210,302         | 0.32%           | 1,755                         |
| Noninterest bearing checking                                 | 658,340                                      |                 |                               | 575,065           |                 |                               |
| Other liabilities                                            | 21,223                                       |                 |                               | 17,030            |                 |                               |
| Shareholders' equity                                         | 349,484                                      |                 |                               | 392,173           |                 |                               |
| Total liabilities and shareholders' equity                   | \$3,332,492                                  |                 |                               | \$3,194,570       |                 |                               |
| Net yield on interest-earning assets and net interest income |                                              | 4.07%           | \$30,654                      |                   | 4.19%           | \$30,093                      |
| Interest rate spread                                         |                                              | 3.99%           |                               |                   | 4.12%           |                               |

Average prime rate

3.50%

3.25%

(1) Average loans include nonaccruing loans, the effect of which is to lower the average rate shown.

Includes tax-equivalent adjustments of \$459,000 and \$390,000 in 2016 and 2015, respectively, to reflect the tax benefit that we receive related to tax-exempt securities, which carry interest rates lower than similar taxable investments due to their tax exempt status. This amount has been computed assuming a 39% tax rate and is reduced by the related nondeductible portion of interest expense.

Average loans outstanding for the first quarter of 2016 were \$2.528 billion, which was \$137 million, or 5.7%, higher than the average loans outstanding for the first quarter of 2015 (\$2.391 billion). The higher amount of average loans outstanding in 2016 is due to loan growth initiatives including expansion into higher growth markets, improved loan demand in our market areas, as well as the hiring of several experienced bankers during 2015.

The mix of our loan portfolio remained substantially the same at March 31, 2016 compared to December 31, 2015, with approximately 89% of our loans being real estate loans, 9% being commercial, financial, and agricultural loans, and the remaining 2% being consumer installment loans. The majority of our real estate loans are personal and commercial loans where real estate provides additional security for the loan.

Average total deposits outstanding for the first quarter of 2016 were \$2.775 billion, which was \$106 million, or 4.0%, higher than the average deposits outstanding for the first quarter of 2015 (\$2.669 billion). Average transaction deposit accounts (noninterest bearing checking, interest bearing checking, money market and savings accounts) increased from \$1.877 billion at March 31, 2015 to \$2.086 billion at March 31, 2016, representing growth of \$210 million, or 11.2%. With the growth of our transaction deposit accounts, we were able to further reduce our reliance on higher cost sources of funding, specifically time deposits. Average time deposits declined from \$792 million at March 31, 2015 to \$689 million at March 31, 2016, a decrease of \$103 million, or 13.1%. Average borrowings increased from \$116 million at March 31, 2015 to \$186 million at March 31, 2016, which helped support loan growth. Although the favorable change in our deposit funding mix benefitted our cost of funds by approximately three basis points, the benefit was largely offset by the increased costs associated with our increased borrowings. Our cost of funds, which includes noninterest bearing checking accounts at a zero percent cost, was 0.25% in the first quarter of 2016 compared to 0.26% in the first quarter of 2015.

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See additional information regarding changes in our loans and deposits in the section below entitled “Financial Condition.”

Our net interest margin (tax-equivalent net interest income divided by average earning assets) for the first quarter of 2016 was 4.07% compared to 4.19% for the first quarter of 2015. The lower margin was primarily due to lower loan yields. Also, we recorded a lower amount of discount accretion related to loans purchased in failed-bank acquisitions (see discussion below).

Our net interest margin benefitted from the net accretion of purchase accounting premiums/discounts associated with the Cooperative acquisition that occurred in June 2009 and, to a lesser degree, the acquisition of The Bank of Asheville in January 2011. For the three months ended March 31, 2016 and 2015, we recorded \$1,055,000 and \$1,557,000, respectively, in net accretion of purchase accounting premiums/discounts that increased net interest income. The decrease in discount accretion in 2016 is due to the unaccreted discount amount that resulted from the failed-bank acquisitions continuing to wind down. Unaccreted loan discount has declined from \$19.1 million at March 31, 2015 to \$14.0 million at March 31, 2016.

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

We recorded total provisions for loan losses of \$0.3 million for the first quarter of 2016 compared to negative provisions for loan losses of \$0.2 million for the first quarter of 2015.

Our provision for loan losses on non-covered loans amounted to \$1.6 million in the first quarter of 2016 compared to \$0.1 million in the first quarter of 2015. In 2015, a prolonged period of stable and improving loan quality trends resulted in a minimal amount of provision for loan losses that was needed to adjust the Company’s allowance for loan losses to the appropriate amount. See additional discussion below in the section titled “Summary of Loan Loss Experience.”

We recorded a negative provision for loan losses on covered loans of \$1.4 million in the first quarter of 2016 compared to a negative provision for loan losses of \$0.3 million in the first quarter of 2015. The increase in the negative provision was primarily due to lower levels of covered nonperforming loans during the period, declining levels of total covered loans, and \$1.0 million in net loan recoveries (recoveries, net of charge-offs) compared to \$0.2 million in net loan recoveries that were realized in the first quarter of 2015.

Total noninterest income was \$5.0 million in the first quarter of 2016 compared to \$4.5 million for the first quarter of 2015.

As presented in the table below, core noninterest income for the first quarter of 2016 was \$7.3 million, an increase of 2.2% from the \$7.2 million reported for the first quarter of 2015. As noted above, core noninterest income includes i) service charges on deposit accounts, ii) other service charges, commissions, and fees, iii) fees from presold mortgages, iv) commissions from financial product sales, and v) bank-owned life insurance income.



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The following table presents our core noninterest income for the three month periods ending March 31, 2016 and 2015, respectively.

| \$ in thousands                                            | For the Three Months Ended |                |
|------------------------------------------------------------|----------------------------|----------------|
|                                                            | March 31,<br>2016          | March 31, 2015 |
| Service charges on deposit accounts                        | \$ 2,685                   | 2,892          |
| Other service charges, commissions, and fees               | 2,830                      | 2,542          |
| Fees from presold mortgages                                | 371                        | 808            |
| Commissions from sales of insurance and financial products | 938                        | 561            |
| Bank-owned life insurance income                           | 508                        | 371            |
| Core noninterest income                                    | \$ 7,332                   | 7,174          |

As shown in the table above, service charges on deposit accounts decreased from \$2.9 million in the first quarter of 2015 to \$2.7 million in the first quarter of 2016. Fewer instances of fees earned from customers overdrawing their accounts have impacted this line item, as well as more customers meeting the requirements to have the monthly services charges waived on their checking accounts.

Other service charges, commissions, and fees increased in 2016 compared to 2015, primarily as a result of higher debit card and credit card interchange fees. We earn a small fee each time a customer uses a debit card to make a purchase. Due to the growth in checking accounts and increased customer usage of debit cards, we have experienced increases in this line item. 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.

Fees from presold mortgages decreased from \$0.8 million in the first quarter of 2015 to \$0.4 million in the first quarter of 2016. Mortgage loan activity decreased this quarter in comparison to the prior year.

Commissions from sales of insurance and financial products amounted to approximately \$0.9 million and \$0.6 million for the first three months of 2016 and 2015, respectively. This line item includes property and casualty insurance commissions, which have increased due to our January 1, 2016 acquisition of Bankingport, Inc., an insurance agency located in Sanford, North Carolina. See Note 15 to the consolidated financial statements for additional information.

Bank-owned life insurance income increased from \$0.4 million in the first quarter of 2015 to \$0.5 million in the first quarter of 2016. In the fourth quarter of 2015, we purchased \$15 million in additional bank owned life insurance, which has resulted in increased income since the purchase.

Within the noncore components of noninterest income, the largest variances related to gains and losses on foreclosed properties. We recorded a net loss on non-covered foreclosed properties of \$0.2 million in the first quarter of 2016 compared a \$0.5 million loss in the first quarter of 2015. Gains on covered foreclosed properties were \$0.4 million for the three months ended March 31, 2016 compared to gains of \$0.2 million recorded for the three months ended March 31, 2015. Losses on non-covered and covered foreclosed properties have generally declined as a result of significantly lower levels of foreclosed properties held by the Company and stabilization in property values.

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Indemnification asset income (expense) is recorded to reflect additional (decreased) amounts expected to be received from the FDIC related to covered assets. The three primary items that result in recording indemnification asset income (expense) are 1) income from loan discount accretion, which results in indemnification expense, 2) provisions (reversals) for loan losses on covered loans, which result in indemnification income (or expense for reversals of provision) and 3) foreclosed property gains (losses) on covered assets, which also result in indemnification expense (income). In each of the first quarters of 2016 and 2015, we recorded \$2.4 million in indemnification asset expense, as shown in the following table:

| (\$ in millions)                                                                          | For the Three Months Ended |                |
|-------------------------------------------------------------------------------------------|----------------------------|----------------|
|                                                                                           | March 31, 2016             | March 31, 2015 |
| Indemnification asset expense associated with loan discount accretion income              | \$ (1.0 )                  | (1.7 )         |
| Indemnification asset income (expense) associated with loan losses (recoveries), net      | (1.0 )                     | (0.4 )         |
| Indemnification asset income (expense) associated with foreclosed property losses (gains) | (0.4 )                     | (0.2 )         |
| Other sources of indemnification asset income (expense)                                   | (0.0 )                     | (0.1 )         |
| Total indemnification asset income (expense)                                              | \$ (2.4 )                  | (2.4 )         |

Noninterest expenses amounted to \$24.8 million in the first quarter of 2016, a 4.5% increase over the \$23.7 million recorded in the same period of 2015.

Salary expense amounted to \$11.5 million for each of the three month periods ended March 31, 2016 and 2015. In 2016, a gross payroll increase of \$0.7 million associated with our growth initiatives was offset by lower incentive compensation expense and higher salary deferrals associated with new loan originations.

Employee benefits expense was \$2.7 million in the first quarter of 2016 compared to \$2.2 million in the first quarter of 2015. This increase was primarily the result of a \$0.4 million increase in employee health insurance expense. We are self-insured for health care expense and experienced unfavorable claim levels in 2016.

The combined amount of occupancy and equipment expense did not vary materially when comparing the first quarter of 2016 to the first quarter of 2015, amounting to approximately \$2.8 million in each quarter.

Other operating expenses amounted to \$7.6 million for the first quarter of 2016 compared to \$7.0 million in the first quarter of 2015, with the increase related to miscellaneous items of other operating expense. The increase was primarily due to higher credit card and debit card fraud losses, as well as legal expenses associated with various

merger and acquisition activities.

For the first quarter of 2016, the provision for income taxes was \$3.3 million, an effective tax rate of 32.7%. For the first quarter of 2015, the provision for income taxes was \$3.7 million, an effective tax rate of 34.6%. Higher levels of tax-exempt loans and bank-owned life insurance, as well as a 100 basis point reduction in the statutory corporate tax rate in North Carolina, contributed to the lower effective tax rate.

We accrued total preferred stock dividends of \$0.1 million and \$0.2 million in the three month periods ended March 31, 2016 and 2015, respectively. The decrease in 2016 is due to our 2015 redemption of preferred stock associated with our prior participation in the U.S. Treasury's Small Business Lending Fund.

The Consolidated Statements of Comprehensive Income reflect other comprehensive income of \$527,000 during the first quarter of 2016 compared to other comprehensive income of \$133,000 during the first quarter of 2015. The primary component of other comprehensive income for the periods presented was changes in unrealized holding gains (losses) of our available for sale securities. Our available for sale securities portfolio is predominantly comprised of fixed rate bonds that generally increase in value when market yields for fixed rate bonds decrease and decline in value when market yields for fixed rate bonds increase. Management has evaluated any unrealized losses on individual securities at each period end and determined that there is no other-than-temporary impairment.

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Total assets at March 31, 2016 amounted to \$3.38 billion, a 5.1% increase from a year earlier. Total loans at March 31, 2016 amounted to \$2.54 billion, a 6.0% increase from a year earlier, and total deposits amounted to \$2.83 billion, a 4.9% increase from a year earlier.

The following table presents information regarding the nature of changes in our levels of loans and deposits for the twelve months ended March 31, 2016 and for the first quarter of 2016.

| April 1, 2015 to<br>March 31, 2016      | Balance at<br>beginning<br>of period | Internal<br>Growth,<br>net | Growth<br>from<br>Acquisitions | Balance at<br>end of<br>period | Total<br>percentage<br>growth | Internal<br>percentage<br>growth |
|-----------------------------------------|--------------------------------------|----------------------------|--------------------------------|--------------------------------|-------------------------------|----------------------------------|
| Loans – Non-covered                     | \$2,275,570                          | 164,260                    | —                              | 2,439,830                      | 7.2%                          | 7.2%                             |
| Loans – Covered                         | 119,829                              | (20,306 )                  | —                              | 99,523                         | -16.9%                        | -16.9%                           |
| Total loans                             | 2,395,399                            | 143,954                    | —                              | 2,539,353                      | 6.0%                          | 6.0%                             |
| Deposits – Noninterest bearing checking | 591,283                              | 87,945                     | —                              | 679,228                        | 14.9%                         | 14.9%                            |
| Deposits – Interest bearing checking    | 578,784                              | 28,833                     | —                              | 607,617                        | 5.0%                          | 5.0%                             |
| Deposits – Money market                 | 568,752                              | 96,539                     | —                              | 665,291                        | 17.0%                         | 17.0%                            |
| Deposits – Savings                      | 183,036                              | 11,537                     | —                              | 194,573                        | 6.3%                          | 6.3%                             |
| Deposits – Brokered                     | 62,801                               | 8,327                      | —                              | 71,128                         | 13.3%                         | 13.3%                            |
| Deposits – Internet time                | 249                                  | (249 )                     | —                              | —                              | -100.0%                       | -100.0%                          |
| Deposits – Time>\$100,000               | 373,599                              | (50,992 )                  | —                              | 322,607                        | -13.6%                        | -13.6%                           |
| Deposits – Time<\$100,000               | 335,110                              | (48,733 )                  | —                              | 286,377                        | -14.5%                        | -14.5%                           |
| Total deposits                          | \$2,693,614                          | 133,207                    | —                              | 2,826,821                      | 4.9%                          | 4.9%                             |
| January 1, 2016 to<br>March 31, 2016    |                                      |                            |                                |                                |                               |                                  |
| Loans – Non-covered                     | \$2,416,285                          | 23,545                     | —                              | 2,439,830                      | 1.0%                          | 1.0%                             |
| Loans – Covered                         | 102,641                              | (3,118 )                   | —                              | 99,523                         | -3.0%                         | -3.0%                            |
| Total loans                             | 2,518,926                            | 20,427                     | —                              | 2,539,353                      | 0.8%                          | 0.8%                             |
| Deposits – Noninterest bearing checking | 659,038                              | 20,190                     | —                              | 679,228                        | 3.1%                          | 3.1%                             |
| Deposits – Interest bearing checking    | 626,878                              | (19,261 )                  | —                              | 607,617                        | -3.1%                         | -3.1%                            |
| Deposits – Money market                 | 636,692                              | 28,599                     | —                              | 665,291                        | 4.5%                          | 4.5%                             |
| Deposits – Savings                      | 186,616                              | 7,957                      | —                              | 194,573                        | 4.3%                          | 4.3%                             |
| Deposits – Brokered                     | 76,412                               | (5,284 )                   | —                              | 71,128                         | -6.9%                         | -6.9%                            |
| Deposits – Internet time                | —                                    | —                          | —                              | —                              | —                             | —                                |
| Deposits – Time>\$100,000               | 329,819                              | (7,212 )                   | —                              | 322,607                        | -2.2%                         | -2.2%                            |
| Deposits – Time<\$100,000               | 295,830                              | (9,453 )                   | —                              | 286,377                        | -3.2%                         | -3.2%                            |

|                |             |        |   |           |      |      |
|----------------|-------------|--------|---|-----------|------|------|
| Total deposits | \$2,811,285 | 15,536 | — | 2,826,821 | 0.6% | 0.6% |
|----------------|-------------|--------|---|-----------|------|------|

As derived from the table above, for the twelve months preceding March 31, 2016, our total loans increased \$144 million, or 6.0%. Internal non-covered loan growth was \$164 million, or 7.2%, for the twelve months ended March 31, 2016, while our covered loans declined by \$20 million, or 16.9%. 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 one to two years. We expect our covered loans to continue to decline as a result of normal pay-downs, foreclosures, and charge-offs. For the first three months of 2016, we experienced internal growth in our non-covered loan portfolio of \$24 million, or 1.0%, which offset the decline in our covered loans of \$3 million.

As previously discussed, on April 1, 2016, we transferred \$17.7 million in loans from “covered” to “non-covered” as a result of the expiration of a loss-share agreement with the FDIC.

The mix of our loan portfolio remains substantially the same at March 31, 2016 compared to December 31, 2015. The majority of our real estate loans are personal and commercial loans where real estate provides additional security for the loan.

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Note 7 to the consolidated financial statements presents additional detailed information regarding our mix of loans, including a break-out between loans covered by FDIC loss share agreements and non-covered loans. Additionally, the section above titled “FDIC Indemnification Asset” contains detail of our covered loans and foreclosed properties segregated by each of the three remaining loss share agreements.

For both the three and twelve month periods ended March 31, 2016, we experienced net increases in total deposits, with growth in transaction account balances (checking, money market, and savings) offsetting the declines in time deposits. Due to the low interest rate environment, some customers are shifting their funds from time deposits into transaction accounts at our company, which do not pay a materially lower interest rate, while being more liquid.

**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 previously discussed, as a result of two FDIC-assisted transactions, we entered into loss share agreements that afford us significant protection from losses from all loans and foreclosed real estate acquired in those acquisitions.

Because of the loss protection provided by the FDIC, the financial risk of the acquired loans and foreclosed real estate is significantly different from the risk associated with assets not covered under the loss share agreements. Accordingly, we present separately nonperforming assets subject to the loss share agreements as “covered” nonperforming assets, and nonperforming assets that are not subject to the loss share agreements as “non-covered.”

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Nonperforming assets are summarized as follows:

| <b>ASSET QUALITY DATA</b> ( <i>\$ in thousands</i> )         | As of/for the<br>quarter ended<br>March 31,<br>2016 | As of/for the<br>quarter ended<br>December 31,<br>2015 | As of/for the<br>quarter ended<br>March 31,<br>2015 |
|--------------------------------------------------------------|-----------------------------------------------------|--------------------------------------------------------|-----------------------------------------------------|
| Non-covered nonperforming assets                             |                                                     |                                                        |                                                     |
| Nonaccrual loans                                             | \$ 35,741                                           | 39,994                                                 | 47,416                                              |
| Restructured loans – accruing                                | 27,055                                              | 28,011                                                 | 33,997                                              |
| Accruing loans >90 days past due                             | —                                                   | —                                                      | —                                                   |
| Total non-covered nonperforming loans                        | 62,796                                              | 68,005                                                 | 81,413                                              |
| Foreclosed real estate                                       | 8,767                                               | 9,188                                                  | 8,978                                               |
| Total non-covered nonperforming assets                       | \$ 71,563                                           | 77,193                                                 | 90,391                                              |
| Covered nonperforming assets (1)                             |                                                     |                                                        |                                                     |
| Nonaccrual loans                                             | \$ 5,670                                            | 7,816                                                  | 8,596                                               |
| Restructured loans – accruing                                | 3,459                                               | 3,478                                                  | 3,874                                               |
| Accruing loans > 90 days past due                            | —                                                   | —                                                      | —                                                   |
| Total covered nonperforming loans                            | 9,129                                               | 11,294                                                 | 12,470                                              |
| Foreclosed real estate                                       | 1,569                                               | 806                                                    | 2,055                                               |
| Total covered nonperforming assets                           | \$ 10,698                                           | 12,100                                                 | 14,525                                              |
| Total nonperforming assets                                   | \$ 82,261                                           | 89,293                                                 | 104,916                                             |
| Asset Quality Ratios – All Assets                            |                                                     |                                                        |                                                     |
| Net charge-offs to average loans - annualized                | 0.35%                                               | 0.23%                                                  | 0.76%                                               |
| Nonperforming loans to total loans                           | 2.83%                                               | 3.15%                                                  | 3.92%                                               |
| Nonperforming assets to total assets                         | 2.43%                                               | 2.66%                                                  | 3.26%                                               |
| Allowance for loan losses to total loans                     | 1.05%                                               | 1.13%                                                  | 1.50%                                               |
| Allowance for loan losses to nonperforming loans             | 37.05%                                              | 36.04%                                                 | 38.34%                                              |
| Asset Quality Ratios – Based on Non-covered Assets only      |                                                     |                                                        |                                                     |
| Net charge-offs to average non-covered loans - annualized    | 0.52%                                               | 0.33%                                                  | 0.84%                                               |
| Non-covered nonperforming loans to non-covered loans         | 2.57%                                               | 2.81%                                                  | 3.58%                                               |
| Non-covered nonperforming assets to total non-covered assets | 2.18%                                               | 2.37%                                                  | 2.92%                                               |
| Allowance for loan losses to non-covered loans               | 1.03%                                               | 1.11%                                                  | 1.48%                                               |
| Allowance for loan losses to non-covered nonperforming loans | 40.21%                                              | 39.39%                                                 | 41.48%                                              |

(1) Covered nonperforming assets consist of assets that are included in loss share agreements with the FDIC.



We have reviewed the collateral for our nonperforming assets, including nonaccrual loans, and have included this review among the factors considered in the evaluation of the allowance for loan losses discussed below.

Consistent with the weak economy experienced in much of our market associated with the onset of the recession in 2008, we experienced higher levels of loan losses, delinquencies and nonperforming assets compared to our historical averages. While economic conditions have improved recently and our asset quality has steadily improved, we continue to have elevated levels of losses and nonperforming assets.

As noted in the table above, at March 31, 2016, total nonaccrual loans (covered and non-covered) amounted to \$41.4 million, compared to \$47.8 million at December 31, 2015 and \$56.0 million at March 31, 2015. Non-covered nonaccrual loans were \$35.7 million, \$40.0 million, and \$47.4 million at March 31, 2016, December 31, 2015 and March 31, 2015, respectively. Nonaccrual loans have steadily declined in recent years as we continue to focus on resolving our problem assets.

“Restructured loans – accruing”, or troubled debt restructurings (TDRs), are accruing loans for which we have granted concessions to the borrower as a result of the borrower’s financial difficulties. As seen in the table above “Asset Quality Data”, at March 31, 2016, total TDRs (covered and non-covered) amounted to \$30.5 million, compared to \$31.5 million at December 31, 2015 and \$37.9 million at March 31, 2015.

Foreclosed real estate includes primarily foreclosed properties. Non-covered foreclosed real estate has decreased over the past year, amounting to \$8.8 million at March 31, 2016, \$9.2 million at December 31, 2015, and \$9.0 million at March 31, 2015. The decreases were the result of sales activity during the periods and the improvement in our overall asset quality.

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At March 31, 2016, we also held \$1.6 million in foreclosed real estate that is subject to the loss share agreements with the FDIC, compared to \$0.8 million at December 31, 2015 and \$2.1 million at March 31, 2015. The increase from December 31, 2015 to March 31, 2016 was due to a property settlement associated with a loan that had been previously charged-off. The decline from March 31, 2015 to December 31, 2015 is primarily due to increased property sales activity, particularly along the North Carolina coast, which is where most of our covered foreclosed properties are located.

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

| (\$ in thousands)                                                  | At March 31,<br>2016 | At December 31,<br>2015 | At March 31,<br>2015 |
|--------------------------------------------------------------------|----------------------|-------------------------|----------------------|
| Commercial, financial, and agricultural                            | \$ 2,514             | 2,964                   | 3,793                |
| Real estate – construction, land development, and other land loans | 4,363                | 4,704                   | 8,715                |
| Real estate – mortgage – residential (1-4 family) first mortgages  | 20,689               | 23,829                  | 23,173               |
| Real estate – mortgage – home equity loans/lines of credit         | 3,129                | 3,525                   | 3,760                |
| Real estate – mortgage – commercial and other                      | 10,483               | 12,571                  | 16,158               |
| Installment loans to individuals                                   | 233                  | 217                     | 413                  |
| Total nonaccrual loans                                             | \$ 41,411            | 47,810                  | 56,012               |

The following segregates our nonaccrual loans at March 31, 2016 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                            | \$ —                           | 2,514                              | 2,514                        |
| Real estate – construction, land development, and other land loans | —                              | 4,363                              | 4,363                        |
| Real estate – mortgage – residential (1-4 family) first mortgages  | 3,097                          | 17,592                             | 20,689                       |
| Real estate – mortgage – home equity loans/lines of credit         | 329                            | 2,800                              | 3,129                        |
| Real estate – mortgage – commercial and other                      | 2,244                          | 8,239                              | 10,483                       |
| Installment loans to individuals                                   | —                              | 233                                | 233                          |
| Total nonaccrual loans                                             | \$ 5,670                       | 35,741                             | 41,411                       |

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

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| (\$ 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                       |

Among non-covered loans, the tables above indicate decreases in most categories of non-covered nonaccrual loans. The decreases reflect stabilization in most of our market areas and our increased focus on the resolution of our nonperforming assets.

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We believe that the fair values of the items of foreclosed real estate, less estimated costs to sell, equal or exceed their respective carrying values at the dates presented. The following table presents the detail of all of our foreclosed real estate at each period end (covered and non-covered):

| (\$ in thousands)                 | At March 31, 2016 | At December 31, 2015 | At March 31, 2015 |
|-----------------------------------|-------------------|----------------------|-------------------|
| Vacant land                       | \$ 4,061          | 3,867                | 4,414             |
| 1-4 family residential properties | 3,872             | 3,789                | 3,136             |
| Commercial real estate            | 2,403             | 2,338                | 3,483             |
| Total foreclosed real estate      | \$ 10,336         | 9,994                | 11,033            |

The following segregates our foreclosed real estate at March 31, 2016 into covered and non-covered:

| (\$ in thousands)                 | Covered Foreclosed Real Estate | Non-covered Foreclosed Real Estate | Total Foreclosed Real Estate |
|-----------------------------------|--------------------------------|------------------------------------|------------------------------|
| Vacant land                       | \$ 1,145                       | 2,916                              | 4,061                        |
| 1-4 family residential properties | 187                            | 3,685                              | 3,872                        |
| Commercial real estate            | 237                            | 2,166                              | 2,403                        |
| Total foreclosed real estate      | \$ 1,569                       | 8,767                              | 10,336                       |

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

| (\$ in thousands)                 | Covered Foreclosed Real Estate | Non-covered Foreclosed Real Estate | Total Foreclosed 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                        |

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The following table presents geographical information regarding our nonperforming assets at March 31, 2016.

|                                                              | As of March 31, 2016 |             |        |                |                                             |
|--------------------------------------------------------------|----------------------|-------------|--------|----------------|---------------------------------------------|
| (\$ in thousands)                                            | Covered              | Non-covered | Total  | Total<br>Loans | Nonperforming<br>Loans to<br>Total<br>Loans |
| <b>Nonaccrual loans and Troubled Debt Restructurings (1)</b> |                      |             |        |                |                                             |
| Eastern Region (NC)                                          | \$6,087              | 14,056      | 20,143 | \$677,000      | 3.0%                                        |
| Triangle Region (NC)                                         | —                    | 17,250      | 17,250 | 765,000        | 2.3%                                        |
| Triad Region (NC)                                            | —                    | 13,559      | 13,559 | 321,000        | 4.2%                                        |
| Charlotte Region (NC)                                        | —                    | 1,859       | 1,859  | 99,000         | 1.9%                                        |
| Southern Piedmont Region (NC)                                | 37                   | 6,630       | 6,667  | 274,000        | 2.4%                                        |
| Western Region (NC)                                          | 2,979                | —           | 2,979  | 86,000         | 3.5%                                        |
| South Carolina Region                                        | 26                   | 2,165       | 2,191  | 118,000        | 1.9%                                        |
| Virginia Region                                              | —                    | 7,277       | 7,277  | 183,000        | 4.0%                                        |
| Other                                                        | —                    | —           | —      | 16,000         | 0.0%                                        |
| Total nonaccrual loans and troubled debt restructurings      | \$9,129              | 62,796      | 71,925 | \$2,539,000    | 2.8%                                        |
| <b>Foreclosed Real Estate (1)</b>                            |                      |             |        |                |                                             |
| Eastern Region (NC)                                          | \$404                | 730         | 1,134  |                |                                             |
| Triangle Region (NC)                                         | —                    | 3,443       | 3,443  |                |                                             |
| Triad Region (NC)                                            | —                    | 1,119       | 1,119  |                |                                             |
| Charlotte Region (NC)                                        | —                    | 853         | 853    |                |                                             |
| Southern Piedmont Region (NC)                                | —                    | 1,095       | 1,095  |                |                                             |
| Western Region (NC)                                          | 1,165                | —           | 1,165  |                |                                             |
| South Carolina Region                                        | —                    | 608         | 608    |                |                                             |
| Virginia Region                                              | —                    | 919         | 919    |                |                                             |
| Other                                                        | —                    | —           | —      |                |                                             |
| Total foreclosed real estate                                 | 1,569                | 8,767       | 10,336 |                |                                             |

(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, Rowan, Mecklenburg

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

### **Summary of 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 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 our real estate loans are primarily 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 weak economic environment that began in 2008 resulted in elevated levels of classified and nonperforming assets, which has generally led to higher provisions for loan losses compared to historical averages. While we are seeing signs of a recovering economy in most of our market areas, it has been a gradual improvement. Although we continue to have an elevated level of past due and adversely classified assets compared to historic averages, we believe the severity of the loss rate inherent in our current inventory of classified loans is less than in recent years.

We recorded a provision for loan losses of \$0.3 million for the first quarter of 2016 compared to a negative provision for loan losses (reduction of the allowance for loan losses) of \$0.2 million for the first quarter of 2015. The total provision for loan losses is comprised of provisions for loan losses for non-covered loans and provisions for loan losses for covered loans, as discussed in the following paragraphs.

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The provision for loan losses on non-covered loans amounted to \$1.6 million in the first quarter of 2016 compared to \$0.1 million in the first quarter of 2015. In 2015, a prolonged period of stable and improving loan quality trends resulted in a minimal amount of provision for loan losses that was needed to adjust our allowance for loan losses to the appropriate amount. This was because 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. In 2015, periods of high net charge-offs we experienced during the peak of the recession dropped out of the analysis and were replaced by the more modest levels of net charge-offs recently experienced. This had the impact of bringing 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. Beginning in the first quarter of 2016, the periods aging out of the analysis are not materially different from recent periods, and thus we expect to continue to see our provision for loan losses correlate more closely with loan growth, charge-offs and other changes in overall loan quality.

Non-covered loan growth for the first three months of 2016 was \$24 million compared to only \$7 million in growth for the three months ended March 31, 2015, which resulted in an incremental provision for the loan losses attributable to loan growth. As it relates to asset quality trends, as shown in a table within Note 7 to the consolidated financial statements, our total non-covered classified and nonaccrual loans decreased from \$102 million at December 31, 2015 to \$95 million at March 31, 2016.

We recorded a negative provision for loan losses on covered loans of \$1.4 million in the first quarter of 2016 compared to a negative provision for loan losses of \$0.3 million in the first quarter of 2015. The increase in the negative provision in 2016 resulted from lower levels of covered nonperforming loans, declining levels of total covered loans and \$1.0 million in net loan recoveries (recoveries, net of charge-offs) compared to net recoveries of \$0.2 million that were realized during the first quarter of 2015.

For the first three months of 2016, we recorded \$2.2 million in net charge-offs, compared to \$4.5 million for the comparable period of 2015. The net charge-offs in 2016 included \$1.0 million of net covered loan recoveries and \$3.2 million of net non-covered loan charge-offs, whereas in 2015 net charge-offs included \$0.2 million of net covered loan recoveries and \$4.7 million in net charge-offs of non-covered loans.

The allowance for loan losses amounted to \$26.6 million at March 31, 2016, compared to \$28.6 million at December 31, 2015 and \$36.0 million at March 31, 2015. The allowance for loan losses for non-covered loans was \$25.2 million, \$26.8 million, and \$33.8 million at March 31, 2016, December 31, 2015, and March 31, 2015 respectively. The ratio of our allowance for non-covered loans to total non-covered loans has declined from 1.48% at March 31, 2015 to 1.03% at March 31, 2016 as a result of the factors discussed above that impacted our provision for loan losses on non-covered loans.

At March 31, 2016, December 31, 2015, and March 31, 2015, the allowance for loan losses attributable to covered loans was \$1.4 million, \$1.8 million, and \$2.2 million, respectively. Our total covered loan portfolio continues to decline as these portfolios wind down.

We believe our reserve levels are 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 reserve 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 amounts 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. See “Critical Accounting Policies — Allowance for Loan Losses” above.

In addition, various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses and value of other real estate. Such agencies may require us to recognize adjustments to the allowance or the carrying value of other real estate based on their judgments about information available at the time of their examinations.



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For the periods indicated, the following table summarizes our balances of loans outstanding, average loans outstanding, changes in the allowance for loan losses arising from charge-offs and recoveries, and additions to the allowance for loan losses that have been charged to expense.

| (\$ in thousands)                                                 | Three Months<br>Ended<br>March 31,<br>2016 | Twelve Months<br>Ended<br>December 31,<br>2015 | Three Months<br>Ended<br>March 31,<br>2015 |
|-------------------------------------------------------------------|--------------------------------------------|------------------------------------------------|--------------------------------------------|
| Loans outstanding at end of period                                | \$ 2,539,353                               | 2,518,926                                      | 2,395,399                                  |
| Average amount of loans outstanding                               | \$ 2,528,317                               | 2,434,602                                      | 2,391,071                                  |
| Allowance for loan losses, at beginning of year                   | \$ 28,583                                  | 40,626                                         | 40,626                                     |
| Provision (reversal) for loan losses                              | 258                                        | (780)                                          | (164)                                      |
|                                                                   | 28,841                                     | 39,846                                         | 40,462                                     |
| Loans charged off:                                                |                                            |                                                |                                            |
| Commercial, financial, and agricultural                           | (721)                                      | (3,039)                                        | (894)                                      |
| Real estate – construction, land development & other land loans   | (340)                                      | (3,616)                                        | (1,329)                                    |
| Real estate – mortgage – residential (1-4 family) first mortgages | (2,030)                                    | (5,145)                                        | (1,514)                                    |
| Real estate – mortgage – home equity loans / lines of credit      | (485)                                      | (1,117)                                        | (116)                                      |
| Real estate – mortgage – commercial and other                     | (248)                                      | (3,103)                                        | (1,296)                                    |
| Installment loans to individuals                                  | (280)                                      | (2,411)                                        | (651)                                      |
| Total charge-offs                                                 | (4,104)                                    | (18,431)                                       | (5,800)                                    |
| Recoveries of loans previously charged-off:                       |                                            |                                                |                                            |
| Commercial, financial, and agricultural                           | 116                                        | 934                                            | 99                                         |
| Real estate – construction, land development & other land loans   | 1,142                                      | 3,599                                          | 753                                        |
| Real estate – mortgage – residential (1-4 family) first mortgages | 305                                        | 678                                            | 102                                        |
| Real estate – mortgage – home equity loans / lines of credit      | 58                                         | 143                                            | 23                                         |
| Real estate – mortgage – commercial and other                     | 175                                        | 1,390                                          | 264                                        |
| Installment loans to individuals                                  | 115                                        | 424                                            | 93                                         |
| Total recoveries                                                  | 1,911                                      | 7,168                                          | 1,334                                      |
| Net charge-offs                                                   | (2,193)                                    | (11,263)                                       | (4,466)                                    |
| Allowance for loan losses, at end of period                       | \$ 26,648                                  | 28,583                                         | 35,996                                     |
| Ratios:                                                           |                                            |                                                |                                            |
| Net charge-offs as a percent of average loans (annualized)        | 0.35%                                      | 0.46%                                          | 0.76%                                      |
| Allowance for loan losses as a percent of loans at end of period  | 1.05%                                      | 1.13%                                          | 1.50%                                      |

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The following table discloses the activity in the allowance for loan losses for the three months ended March 31, 2016, segregated into covered and non-covered.

| (\$ in thousands)                                                 | As of March 31, 2016 |             |           |
|-------------------------------------------------------------------|----------------------|-------------|-----------|
|                                                                   | Covered              | Non-covered | Total     |
| Loans outstanding at end of period                                | \$99,523             | 2,439,830   | 2,539,353 |
| Average amount of loans outstanding                               | \$101,083            | 2,427,234   | 2,528,317 |
| Allowance for loan losses, at beginning of year                   | \$1,799              | 26,784      | 28,583    |
| Provision (reversal) for loan losses                              | (1,363 )             | 1,621       | 258       |
|                                                                   | 436                  | 28,405      | 28,841    |
| Loans charged off:                                                |                      |             |           |
| Commercial, financial, and agricultural                           | (44 )                | (677 )      | (721 )    |
| Real estate – construction, land development & other land loans   | —                    | (340 )      | (340 )    |
| Real estate – mortgage – residential (1-4 family) first mortgages | (78 )                | (1,952 )    | (2,030 )  |
| Real estate – mortgage – home equity loans / lines of credit      | (36 )                | (449 )      | (485 )    |
| Real estate – mortgage – commercial and other                     | (83 )                | (165 )      | (248 )    |
| Installment loans to individuals                                  | —                    | (280 )      | (280 )    |
| Total charge-offs                                                 | (241 )               | (3,863 )    | (4,104 )  |
| Recoveries of loans previously charged-off:                       |                      |             |           |
| Commercial, financial, and agricultural                           | 30                   | 86          | 116       |
| Real estate – construction, land development & other land loans   | 1,052                | 90          | 1,142     |
| Real estate – mortgage – residential (1-4 family) first mortgages | 72                   | 233         | 305       |
| Real estate – mortgage – home equity loans / lines of credit      | 3                    | 55          | 58        |
| Real estate – mortgage – commercial and other                     | 45                   | 130         | 175       |
| Installment loans to individuals                                  | 2                    | 113         | 115       |
| Total recoveries                                                  | 1,204                | 707         | 1,911     |
| Net (charge-offs)/recoveries                                      | 963                  | (3,156 )    | (2,193 )  |
| Allowance for loan losses, at end of period                       | \$1,399              | 25,249      | 26,648    |

The following table discloses the activity in the allowance for loan losses for the three months ended March 31, 2015, segregated into covered and non-covered.

| (\$ in thousands)                               | As of March 31, 2015 |             |           |
|-------------------------------------------------|----------------------|-------------|-----------|
|                                                 | Covered              | Non-covered | Total     |
| Loans outstanding at end of period              | \$119,829            | 2,275,570   | 2,395,399 |
| Average amount of loans outstanding             | \$123,712            | 2,267,359   | 2,391,071 |
| Allowance for loan losses, at beginning of year | \$2,281              | 38,345      | 40,626    |

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|                                                                   |         |          |          |
|-------------------------------------------------------------------|---------|----------|----------|
| Provision (reversal) for loan losses                              | (268 )  | 104      | (164 )   |
|                                                                   | 2,013   | 38,449   | 40,462   |
| Loans charged off:                                                |         |          |          |
| Commercial, financial, and agricultural                           | —       | (894 )   | (894 )   |
| Real estate – construction, land development & other land loans   | —       | (1,329 ) | (1,329 ) |
| Real estate – mortgage – residential (1-4 family) first mortgages | (99 )   | (1,415 ) | (1,514 ) |
| Real estate – mortgage – home equity loans / lines of credit      | (41 )   | (75 )    | (116 )   |
| Real estate – mortgage – commercial and other                     | (300 )  | (996 )   | (1,296 ) |
| Installment loans to individuals                                  | —       | (651 )   | (651 )   |
| Total charge-offs                                                 | (440 )  | (5,360 ) | (5,800 ) |
| Recoveries of loans previously charged-off:                       |         |          |          |
| Commercial, financial, and agricultural                           | 12      | 87       | 99       |
| Real estate – construction, land development & other land loans   | 487     | 266      | 753      |
| Real estate – mortgage – residential (1-4 family) first mortgages | 89      | 13       | 102      |
| Real estate – mortgage – home equity loans / lines of credit      | 2       | 21       | 23       |
| Real estate – mortgage – commercial and other                     | 62      | 202      | 264      |
| Installment loans to individuals                                  | 1       | 92       | 93       |
| Total recoveries                                                  | 653     | 681      | 1,334    |
| Net (charge-offs)/recoveries                                      | 213     | (4,679 ) | (4,466 ) |
| Allowance for loan losses, at end of period                       | \$2,226 | 33,770   | 35,996   |

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Based on the results of our loan analysis and grading program and our evaluation of the allowance for loan losses at March 31, 2016, there have been no material changes to the allocation of the allowance for loan losses among the various categories of loans since December 31, 2015.

**Liquidity, Commitments, and Contingencies**

Our liquidity is determined by our ability to convert assets to cash or acquire alternative sources of funds to meet the needs of our customers who are withdrawing or borrowing funds, and 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.

In addition to internally generated liquidity sources, we have the ability to obtain borrowings from the following four sources - 1) an approximately \$580 million line of credit with the Federal Home Loan Bank (of which \$140 million was outstanding at March 31, 2016), 2) a \$50 million overnight federal funds line of credit with a correspondent bank (of which none was outstanding at March 31, 2016), 3) a \$35 million federal funds line with a correspondent bank (of which none was outstanding at March 31, 2016), and 4) an approximately \$92 million line of credit through the Federal Reserve Bank of Richmond's discount window (of which none was outstanding at March 31, 2016). In addition to the outstanding borrowings from the FHLB that reduce the available borrowing capacity of that line of credit, our borrowing capacity was reduced by \$193 million at both March 31, 2016 and 2015 as a result of our pledging letters of credit for public deposits at each of those dates. Unused and available lines of credit amounted to \$550 million at March 31, 2016 compared to \$429 million at December 31, 2015.

Our overall liquidity decreased slightly since March 31, 2015 due primarily to loan growth and the redemption of the \$63.5 million in SBLF stock in the second half of 2015. Our liquid assets (cash and securities) as a percentage of our total deposits and borrowings decreased from 21.1% at March 31, 2015 to 19.8% at March 31, 2016.

We 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.

The amount and timing of our contractual obligations and commercial commitments has not changed materially since December 31, 2015, detail of which is presented in Table 18 on page 90 of our 2015 Annual Report on Form 10-K.

We are not involved in any other legal proceedings that, in our opinion, could have a material effect on our consolidated financial position.

### **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 derivative activities through March 31, 2016, and have no current plans to do so.

### **Capital Resources**

We are regulated by the Board of Governors of the Federal Reserve Board (FED) and are subject to the securities registration and public reporting regulations of the Securities and Exchange Commission. Our banking subsidiary is also regulated by the North Carolina Office of the Commissioner of Banks. 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.

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We 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 our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. Our capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The capital standards require us to maintain minimum ratios of “Common Equity Tier 1” capital to total risk-weighted assets, “Tier 1” 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 1 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 1 capital is comprised of Common Equity Tier 1 capital plus Additional Tier 1 Capital, which for the Company includes non-cumulative perpetual preferred stock and trust preferred securities. Total capital is comprised of Tier 1 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 regulations.

The capital conservation buffer requirement began to be phased in on January 1, 2016, at 0.625% of risk weighted assets, and will increase each year until fully implemented at 2.5% in January 1, 2019.

In addition to the risk-based capital requirements described above, we are subject to a leverage capital requirement, which calls for a minimum ratio of Tier 1 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 us of any requirement specifically applicable to us.

At March 31, 2016, our capital ratios exceeded the regulatory minimum ratios discussed above. The following table presents our capital ratios and the regulatory minimums discussed above for the periods indicated.

|                                                     | March 31,<br>2016 | December 31,<br>2015 | March 31,<br>2015 |
|-----------------------------------------------------|-------------------|----------------------|-------------------|
| Risk-based capital ratios:                          |                   |                      |                   |
| Common equity Tier 1 to Tier 1 risk weighted assets | 11.35%            | 11.22%               | 11.40%            |
| Minimum required Common equity Tier 1 capital       | 4.50%             | 4.50%                | 4.50%             |
|                                                     |                   |                      |                   |
| Tier I capital to Tier 1 risk weighted assets       | 13.40%            | 13.30%               | 16.36%            |
| Minimum required Tier 1 capital                     | 6.00%             | 6.00%                | 6.00%             |

|                                                          |        |        |        |
|----------------------------------------------------------|--------|--------|--------|
| Total risk-based capital to Tier II risk weighted assets | 14.45% | 14.45% | 17.61% |
| Minimum required total risk-based capital                | 8.00%  | 8.00%  | 8.00%  |
| Leverage capital ratios:                                 |        |        |        |
| Tier 1 capital to quarterly average total assets         | 10.40% | 10.38% | 12.17% |
| Minimum required Tier 1 leverage capital                 | 4.00%  | 4.00%  | 4.00%  |

Our bank subsidiary is also subject to capital requirements similar to those discussed above. The bank subsidiary's capital ratios do not vary materially from our capital ratios presented above. At March 31, 2016, our bank subsidiary exceeded the minimum ratios established by the regulatory authorities.

Our capital ratios decreased from March 31, 2015 due to the redemption of \$63.5 million in preferred stock in 2015 (see Note 14 to the Consolidated Financial Statements for more information on this transaction).

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 8.24% at March 31, 2016 compared to 8.13% at December 31, 2015 and 8.08% at March 31, 2015.

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**BUSINESS DEVELOPMENT MATTERS**

The following is a list of business development and other miscellaneous matters affecting First Bancorp and First Bank, our bank subsidiary.

On March 4, 2016, the Company announced that it had reached an agreement with First Community Bank to exchange all seven First Bank branches in Virginia in return for six of First Community Bank's branches located in North Carolina. Four of the six branches expected to be acquired are in Winston-Salem, with the other two branches being in the Charlotte-metro markets of Mooresville and Huntersville. This transaction is subject to regulatory approval and is expected to be completed in the third quarter of 2016.

On January 1, 2016, the Company completed the acquisition of Bankingport, Inc., an insurance agency based in Sanford, North Carolina. This acquisition provided the Company the opportunity to enhance its product offerings, as well as expand its insurance agency operations into Sanford, a significant banking market for the Company.

On March 15, 2016, the Company announced a quarterly cash dividend of \$0.08 cents per share payable on April 25, 2016 to shareholders of record on March 31, 2016. This is the same dividend rate as the Company declared in the first quarter of 2015.

**SHARE REPURCHASES**

We did not repurchase any shares of our common stock during the first three months of 2016. At March 31, 2016, we had approximately 214,000 shares available for repurchase under existing authority from our board of directors. We may repurchase these shares in open market and privately negotiated transactions, as market conditions and our liquidity warrants, subject to compliance with applicable regulations. See also Part II, Item 2 "Unregistered Sales of Equity Securities and Use of Proceeds."

Item 3 – Quantitative and Qualitative Disclosures About Market Risk

**INTEREST RATE RISK (INCLUDING QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK)**



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 March 31, 2016, approximately 73% 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.

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), at March 31, 2016, we had approximately \$1.0 billion 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 March 31, 2016 are deposits totaling \$1.5 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.

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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.

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 were also 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 \$1.1 million and

\$1.6 million for the first quarters of 2016 and 2015, respectively, is less predictable and could 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 \$12.5 million at March 31, 2016, we expect that loan discount accretion, and the related indemnification asset expense associated with the accretion, will continue to 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).

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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 the remainder of 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.

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.

Item 4 – 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. In addition, no change in our internal control over financial reporting has occurred during, or subsequent to, the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Part II. Other Information**

Item 1 – 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.

## Item 1A - Risk Factors

Investing in share of our common stock involves certain risks, including those identified and described in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2015, as well as cautionary statements contained in this Form 10-Q, including those under the caption "Forward-Looking Statements" set forth in the forepart of this Form 10-Q, risks and matters described elsewhere in this Form 10-Q and in our other filings with the SEC.

## Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds

### Issuer Purchases of Equity Securities

| Period                                | Total Number of Shares Purchased (2) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1) | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1) |
|---------------------------------------|--------------------------------------|------------------------------|--------------------------------------------------------------------------------------|------------------------------------------------------------------------------------|
| January 1, 2016 to January 31, 2016   | —                                    | —                            | —                                                                                    | 214,241                                                                            |
| February 1, 2016 to February 29, 2016 | —                                    | —                            | —                                                                                    | 214,241                                                                            |
| March 1, 2016 to March 31, 2016       | —                                    | —                            | —                                                                                    | 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 we do 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 March 31, 2016.

During the three months ended March 31, 2016, the Company issued 79,012 shares of unregistered common stock in completing the acquisition of Bankingport, Inc. — see Note 15 to the consolidated financial statements for additional information. The Company relied upon the exemption from registration provided by Section 4(2) of the Securities Act of 1933 for transactions not involving any public offering due to the small number of shareholders of Bankingport,

Inc., their level of financial sophistication and the absence of any general solicitation. There were no other unregistered sales of the Company's securities during the three months ended March 31, 2016.

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Item 6 - Exhibits

The following exhibits are filed with this report or, as noted, are incorporated by reference. Except as noted below the exhibits identified have Securities and Exchange Commission 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.
- 4.c 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.a Purchase and Assumption Agreement, dated as of March 3, 2016 between First Bank (as Seller) and First Community Bank (as Purchaser) was filed as Exhibit 99.2 to the Company's Current Report on Form 8-K filed on March 7, 2016, and is incorporated herein by reference.
- 10.b Purchase and Assumption Agreement, dated as of March 3, 2016 between First Community Bank (as Seller) and First Bank (as Purchaser) was filed as Exhibit 99.3 to the Company's Current Report on Form 8-K filed on March 7, 2016, and is incorporated herein by reference.

- 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 Quarterly Report on Form 10-Q for the quarter ended March 31, 2016, formatted in eXtensible Business Reporting Language (XBRL): (i) the Consolidated Balance 101 Sheets, (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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**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 the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FIRST BANCORP

May 10, 2016 BY:/s/ Richard H. Moore  
Richard H. Moore  
Chief Executive Officer  
(Principal Executive Officer),  
Treasurer and Director

May 10, 2016 BY:/s/ Eric P. Credle  
Eric P. Credle  
Executive Vice President  
and Chief Financial Officer