FIRST BANCORP /NC/
Form 10-K
March 16, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2008

Commission File Number 0-15572

FIRST BANCORP

(Exact Name of Registrant as Specified in its Charter)

North Carolina (State of Incorporation)	56-1421916 (I.R.S. Employer Identification Number)
341 North Main Street, Troy, North Carolina (Address of Principal Executive Offices)	27371-0508 (Zip Code)
Registrant’s telephone number, including area code:	(910) 576-6171

Securities Registered Pursuant to Section 12(b) of the Act:
COMMON STOCK, NO PAR VALUE
(Title of each class)

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

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

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

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

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

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

£ Large Accelerated Filer	T Accelerated Filer	£ Non-Accelerated Filer (Do not check if a smaller reporting company)	£ 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 T NO

The aggregate market value of the Common Stock, no par value, held by non-affiliates of the registrant, based on the closing price of the Common Stock as of June 30, 2008 as reported by The NASDAQ Global Select Market, was approximately $184,375,180.

The number of shares of the registrant's Common Stock outstanding on February 27, 2009 was 16,617,846.

DOCUMENTS INCORPORATED BY REFERENCE

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

TABLE OF CONTENTS

Table of Contents

*Information called for by Part III (Items 10 through 14) is incorporated herein by reference to the Registrant's definitive Proxy Statement for the 2009 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission on or before April 30, 2009.

Table of Contents

FORWARD-LOOKING STATEMENTS

This report contains statements that could be deemed forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 and the Private Securities Litigation Reform Act, 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. 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. 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 that could affect the matters discussed in this paragraph, see the "Risk Factors" section in Item 1A of this report.

PART I

Item 1. Business

General Description

The Company

First Bancorp (the "Company") is a bank holding company. The principal activity of the Company is the ownership and operation of First Bank (the "Bank"), a state-chartered bank with its main office in Troy, North Carolina. The Company also owns and operates a nonbank subsidiary, Montgomery Data Services, Inc. ("Montgomery Data"), a data processing company. This subsidiary is fully consolidated for financial reporting purposes. The Company is also the parent to a series of statutory business trusts organized under the laws of the State of Delaware that were created for the purpose of issuing trust preferred debt securities. The Company's outstanding debt associated with these trusts was $46.4 million at December 31, 2008 and 2007.

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

The Bank was organized in 1934 and began banking operations in 1935 as the Bank of Montgomery, named for the county in which it operated. As of December 31, 2008, the Bank operated in a 28-county area centered in Troy, North Carolina. Troy, population 3,500, is located in the center of Montgomery County, approximately 60 miles east of Charlotte, 50 miles south of Greensboro, and 80 miles southwest of Raleigh. The Bank conducts business from 74 branches located within a 120-mile radius of Troy, covering principally a geographical area from Florence, South Carolina to the southeast, to Wilmington, North Carolina to the east, to Radford, Virginia to the north, to Wytheville, Virginia to the northwest, and to Harmony, North Carolina to the west. The Bank also has a loan production office in Blacksburg, which is located in southwestern Virginia and represents the Bank's furthest location to the north of Troy. Of the Bank's 74 branches, 63 are in North Carolina, with six branches in South Carolina and five branches in Virginia (where the Bank operates under the name "First Bank of Virginia"). Ranked by assets, the Bank was the 6th largest bank headquartered in North Carolina as of December 31, 2008.

As of December 31, 2008, the Bank had one wholly owned subsidiary, First Bank Insurance Services, Inc. ("First Bank Insurance"). First Bank Insurance was acquired as an active insurance agency in 1994 in connection

4

Table of Contents

with the Company's acquisition of a bank that had an insurance subsidiary. On December 29, 1995, the insurance agency operations of First Bank Insurance were divested. From December 1995 until October 1999, First Bank Insurance was inactive. In October 1999, First Bank Insurance began operations again as a provider of non-FDIC insured investments and insurance products. Currently, First Bank Insurance's primary business activity is the placement of property and casualty insurance coverage.

The Company's principal executive offices are located at 341 North Main Street, Troy, North Carolina 27371-0508, and its telephone number is (910) 576-6171. Unless the context requires otherwise, references to the "Company" in this annual report on Form 10-K shall mean collectively First Bancorp and its consolidated subsidiaries.

General Business

The Bank engages in a full range of banking activities, with the acceptance of deposits and the making of loans being its most basic activities. The Bank offers deposit products such as checking, savings, NOW and money market accounts, as well as time deposits, including various types of certificates of deposits (CDs) and individual retirement accounts (IRAs). The Bank provides loans for a wide range of consumer and commercial purposes, including loans for business, agriculture, real estate, personal uses, home improvement and automobiles. The Bank also offers credit cards, debit cards, letters of credit, safe deposit box rentals, bank money orders and electronic funds transfer services, including wire transfers. In addition, the Bank offers internet banking, cash management and bank-by-phone capabilities to its customers, and is affiliated with ATM networks that give Bank customers access to 55,000 ATMs, with no surcharge fee. In 2005, the Bank began offering repurchase agreements (also called securities sold under agreement to repurchase), which are similar to interest-bearing deposits and allow the Bank to pay interest to business customers without statutory limitations on the number of withdrawals that these customers can make. In 2007, the Bank introduced remote deposit capture, which provides business customers with a method to electronically transmit checks received from customers into their bank account without having to visit a branch. Also in 2007, the Bank began an initiative to grow its Hispanic customer base by opening two uniquely Hispanic branches under the trade name "Primer Banco," which means First Bank in Spanish. The Hispanic population is the fastest growing segment in the Bank's market area. In 2008, the Bank joined the Certificate of Deposit Account Registry Service (CDARS), which gives our customers the ability to obtain FDIC insurance on deposits of up to $50 million, while continuing to work directly with their local First Bank branch.

Because the majority of the Bank's customers are individuals and small to medium-sized businesses located in the counties it serves, management does not believe that the loss of a single customer or group of customers would have a material adverse impact on the Bank. There are no seasonal factors that tend to have any material effect on the Bank's business, and the Bank does not rely on foreign sources of funds or income. Because the Bank operates primarily within the central Piedmont region of North Carolina, the economic conditions within that area could have a material impact on the Company. See additional discussion below in the section entitled "Territory Served and Competition."

Beginning in 1999, First Bank Insurance began offering non-FDIC insured investment and insurance products, including mutual funds, annuities, long-term care insurance, life insurance, and company retirement plans, as well as financial planning services (the "investments division"). In May 2001, First Bank Insurance added to its product line when it acquired two insurance agencies that specialized in the placement of property and casualty insurance. In October 2003, the "investments division" of First Bank Insurance became a part of the Bank. The primary activity of First Bank Insurance is now the placement of property and casualty insurance products.

Montgomery Data's primary business is to provide electronic data processing services for the Bank. Ownership and operation of Montgomery Data allows the Company to do all of its electronic data processing without paying fees for such services to an independent provider. Maintaining its own data processing system

5

Table of Contents

also allows the Company to adapt the system to its individual needs and to the services and products it offers. Although not a significant source of income, Montgomery Data has historically made its excess data processing capabilities available to area financial institutions for a fee. For the years ended December 31, 2008, 2007 and 2006, external customers provided gross revenues of $167,000, $204,000 and $162,000, respectively. As of December 31, 2008 Montgomery Data had one outside customer. Montgomery Data continues to market its services to area banks, but does not currently have any near-term prospects for additional business.

Until December 31, 2007, the Company had another subsidiary, First Bancorp Financial Services. First Bancorp Financial was originally organized under the name of First Recovery in September of 1988 for the purpose of providing a back-up data processing site for Montgomery Data and other financial and non-financial clients. First Recovery’s back-up data processing operations were divested in 1994. Since that time, First Bancorp Financial had been occasionally used to purchase and dispose of parcels of real estate that had been acquired by the Bank through foreclosure or from branch closings. First Bancorp Financial Services had been substantially inactive for most of the last decade, and the Company elected to dissolve this subsidiary effective December 31, 2007.

First Bancorp Capital Trust I was organized in October 2002 for the purpose of issuing $20.6 million in debt securities. These debt securities were called by the Company at par on November 7, 2007 and First Bancorp Capital Trust I was dissolved.

First Bancorp Capital Trust II and First Bancorp Capital Trust III were organized in December 2003 for the purpose of issuing $20.6 million in debt securities ($10.3 million were issued from each trust). These borrowings are due on January 23, 2034 and are also structured as trust preferred capital securities in order to qualify as regulatory capital. These debt securities are callable by the Company at par on any quarterly interest payment date beginning on January 23, 2009. The interest rate on these debt securities adjusts on a quarterly basis at a weighted average rate of three-month LIBOR plus 2.70%.

First Bancorp Capital Trust IV was organized in April 2006 for the purpose of issuing $25.8 million in debt securities. These borrowings are due on June 15, 2036 and are structured as trust preferred capital securities, which qualify as capital for regulatory capital adequacy requirements. These debt securities are callable by the Company at par on any quarterly interest payment date beginning on June 15, 2011. The interest rate on these debt securities adjusts on a quarterly basis at a rate of three-month LIBOR plus 1.39%.

Table of Contents

Territory Served and Competition

The Company's headquarters are located in Troy, Montgomery County, North Carolina. The Company serves primarily the south central area of the Piedmont region of North Carolina. The following table presents, for each county where the Company operates, the number of bank branches operated by the Company within the county at December 31, 2008, the approximate amount of deposits with the Company in the county as of December 31, 2008, the Company's approximate market share at June 30, 2008, and the number of bank competitors located in the county at June 30, 2008.

County	No. of Branches	Deposits (in millions)	Market Share	Number of Competitors
Anson, NC	1	$ 10	4.2%	5
Brunswick, NC	3	36	2.1%	12
Cabarrus, NC	2	33	1.7%	11
Chatham, NC	2	65	8.0%	10
Chesterfield, SC	2	60	20.1%	8
Davidson, NC	3	106	5.4%	10
Dillon, SC	3	72	25.5%	3
Duplin, NC	3	70	14.2%	7
Florence, SC	1	34	2.3%	15
Guilford, NC	1	45	0.4%	22
Harnett, NC	3	119	12.9%	10
Iredell, NC	2	33	1.4%	22
Lee, NC	4	208	26.6%	10
Montgomery, NC	5	97	36.6%	4
Montgomery, VA	1	24	1.6%	12
Moore, NC	11	380	25.9%	11
New Hanover, NC	2	26	0.5%	20
Pulaski, VA	1	22	5.7%	8
Randolph, NC	5	61	3.7%	15
Richmond, NC	1	23	6.9%	6
Robeson, NC	5	163	16.9%	10
Rockingham, NC	1	25	2.3%	10
Rowan, NC	2	50	2.8%	12
Scotland, NC	2	54	15.7%	6
Stanly, NC	4	92	10.8%	6
Wake, NC	1	16	0.1%	30
Washington, VA	1	18	2.0%	16
Wythe, VA	2	49	10.4%	10
Brokered & Internet Deposits	-	84		
Total	74	$ 2,075		

The Company's 74 branches and facilities are primarily located in small communities whose economies are based primarily on services, manufacturing and light industry. Although the Company's market is predominantly small communities and rural areas, the market area is not dependent on agriculture. Textiles, furniture, mobile homes, electronics, plastic and metal fabrication, forest products, food products, chicken hatcheries, and cigarettes are among the leading manufacturing industries in the trade area. Leading producers of lumber and rugs are located in Montgomery County. The Pinehurst area within Moore County is a widely known golf resort and retirement area. The High Point area is widely known for its furniture market. New Hanover and Brunswick Counties, located in the southeastern coastal region of North Carolina, are popular with tourists and have significant retirement populations. Additionally, several of the communities served by the Company are “bedroom” communities of large cities like Charlotte, Raleigh and Greensboro, while several branches are located in medium-sized cities such as Albemarle, Asheboro, High Point, Southern Pines and Sanford. The Company also has branches in small communities such as Bennett, Polkton, Vass, and Harmony.

Approximately 18% of the Company’s deposit base is in Moore County, and approximately 10% is in Lee

County. Accordingly, material changes in competition, the economy or population of Moore or Lee counties could materially impact the Company. No other county comprises more than 10% of the Company's deposit base.

The Company competes in its various market areas with, among others, several large interstate bank holding companies. These large competitors have substantially greater resources than the Company, including broader geographic markets, higher lending limits and the ability to make greater use of large-scale advertising and promotions. A significant number of interstate banking acquisitions have taken place in the past decade, thus further increasing the size and financial resources of some of the Company's competitors, two of which are among the largest bank holding companies in the nation. In many of the Company's markets, the Company also competes against banks that have been organized within the past ten years. These new banks often focus on loan and deposit balance sheet growth, and not necessarily on earnings profitability. This strategy often allows them to offer more attractive terms on loans and deposits than the Company is able to offer because the Company must achieve an acceptable level of profitability. Moore County, which as noted above comprises a disproportionate share of the Company's deposits, is a particularly competitive market, with at least eleven other financial institutions having a physical presence. See "Supervision and Regulation" below for a further discussion of regulations in the Company's industry that affect competition.

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

Despite the competitive market, the Company believes it has certain advantages over its competition in the areas it serves. The Company seeks to maintain a distinct local identity in each of the communities it serves and actively sponsors and participates in local civic affairs. Most lending and other customer-related business decisions can be made without delays often associated with larger systems. Additionally, employment of local managers and personnel in various offices and low turnover of personnel enable the Company to establish and maintain long-term relationships with individual and corporate customers.

Lending Policy and Procedures

Conservative lending policies and procedures and appropriate underwriting standards are high priorities of the Bank. Loans are approved under the Bank's written loan policy, which provides that lending officers, principally branch managers, have authority to approve loans of various amounts up to $350,000, with lending limits varying depending upon whether the loan is secured or unsecured. Each of the Bank's regional senior lending officers has discretion to approve secured loans of various principal amounts up to $500,000 and together can approve loans up to $4,000,000. Loans above $4,000,000 must be approved by the Executive Committee of the board of directors.

The Bank's board of directors reviews and approves loans that exceed management's lending authority, loans to executive officers, directors, and their affiliates and, in certain instances, other types of loans. New credit extensions are reviewed daily by the Bank's senior management and at least monthly by its board of directors.

The Bank continually monitors its loan portfolio to identify areas of concern and to enable management to take corrective action. Lending officers and the board of directors meet periodically to review past due loans and portfolio quality, while assuring that the Bank is appropriately meeting the credit needs of the communities it serves. Individual lending officers are responsible for pursuing collection of past-due amounts and monitoring any changes in the financial status of borrowers.

8

Table of Contents

The Bank also contracts with an independent consulting firm to review new loan originations meeting certain criteria, as well as to assign risk grades to existing credits meeting certain thresholds. The consulting firm's observations, comments, and risk grades, including variances with the Bank's risk grades, are shared with the audit committee of the Company's board of directors and are considered by management in setting Bank policy, as well as in evaluating the adequacy of the allowance for loan losses. The consulting firm also provides training on a periodic basis to the Company's loan officers to keep them updated on current developments in the marketplace. For additional information, see "Allowance for Loan Losses and Loan Loss Experience" under Item 7 below.

Investment Policy and Procedures

The Company has adopted an investment policy designed to maximize the Company's income from funds not needed to meet loan demand, in a manner consistent with appropriate liquidity and risk objectives. Pursuant to this policy, the Company may invest in federal, state and municipal obligations, federal agency obligations, public housing authority bonds, industrial development revenue bonds, Federal Home Loan Bank bonds, Fannie Mae bonds, Government National Mortgage Association bonds, Freddie Mac bonds, Student Loan Marketing Association bonds, and, to a limited extent, corporate bonds. Except for corporate bonds, the Company's investments must be rated at least Baa by Moody's or BBB by Standard and Poor's. Securities rated below A are periodically reviewed for creditworthiness. The Company may purchase non-rated municipal bonds only if such bonds are in the Company's general market area and determined by the Company to have a credit risk no greater than the minimum ratings referred to above. Industrial development authority bonds, which normally are not rated, are purchased only if they are judged to possess a high degree of credit soundness to assure reasonably prompt sale at a fair value. The Company is also authorized by its board of directors to invest a portion of its securities portfolio in high quality corporate bonds, with the amount of such bonds not to exceed 15% of the entire securities portfolio. Prior to purchasing a corporate bond, the Company's management performs due diligence on the issuer of the bond, and the purchase is not made unless the Company believes that the purchase of the bond bears no more risk to the Company than would an unsecured loan to the same company.

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

Mergers and Acquisitions

As part of its operations, the Company has pursued an acquisition strategy over the years to augment its internal growth. The Company regularly evaluates the potential acquisition of, or merger with, various financial institutions. The Company's acquisitions to date have generally fallen into one of three categories - 1) an acquisition of a financial institution or branch thereof within a market in which the Company operates, 2) an acquisition of a financial institution or branch thereof in a market contiguous or nearly contiguous to a market in which the Company operates, or 3) an acquisition of a company that has products or services that the Company does not currently offer.

The Company believes that it can enhance its earnings by pursuing these types of acquisition opportunities through any combination or all of the following: 1) achieving cost efficiencies, 2) enhancing the acquiree's earnings or gaining new customers by introducing a more successful banking model with more products and services to the acquiree's market base, 3) increasing customer satisfaction or gaining new customers by providing more locations for the convenience of customers, and 4) leveraging the Company's customer base by offering new products and services.

Since 2000, the Company has completed acquisitions in all three categories described above. During that time, the Company has 1) completed four whole-bank acquisitions, with one being in the existing market area and the other three being in contiguous markets, with total assets exceeding $700 million, 2) purchased ten bank branches from other banks (both in the existing market area and in contiguous/nearly contiguous markets) with total assets of approximately $250 million, and 3) acquired two insurance agencies, which provided the Company with the ability to offer property and casualty insurance coverage.

There are many factors that the Company considers when evaluating how much to offer for potential acquisition candidates - in the form of a purchase price comprised of cash and/or stock for a whole company purchase or a deposit premium in a branch purchase. Most significantly, the Company compares expectations of future earnings per share on a stand-alone basis with projected future earnings per share assuming completion of the acquisition under various pricing scenarios. Significant assumptions that affect this analysis include the estimated future earnings stream of the acquisition candidate, the amount of cost efficiencies that can be realized, and the interest rate earned/lost on the cash received/paid. In addition to the earnings per share comparison, the Company also considers other factors including (but not limited to) marketplace acquisition statistics, location of the candidate in relation to the Company's expansion strategy, market growth potential, management of the candidate, potential integration issues (including corporate culture), and the size of the acquisition candidate.

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

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

Employees

As of December 31, 2008, the Company had 612 full-time and 75 part-time employees. The Company is not a party to any collective bargaining agreements and considers its employee relations to be good.

Supervision and Regulation

As a bank holding company, the Company is subject to supervision, examination and regulation by the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") and the North Carolina Office of the Commissioner of Banks (the "Commissioner"). The Bank is subject to supervision and examination by the Federal Deposit Insurance Corporation (the "FDIC") and the Commissioner. For additional information, see also Note 15 to the consolidated financial statements.

Supervision and Regulation of the Company

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

A bank holding company is required to file quarterly reports and other information regarding its business operations and those of its subsidiaries with the Federal Reserve Board. It is also subject to examination by the Federal Reserve Board and is required to obtain Federal Reserve Board approval prior to making certain acquisitions of other institutions or voting securities. The Commissioner is empowered to regulate certain acquisitions of North Carolina banks and bank holding companies, issue cease and desist orders for violations of North Carolina banking laws, and promulgate rules necessary to effectuate the purposes of the North Carolina

Table of Contents

Bank Holding Company Act of 1984.

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

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

In 2002, the Sarbanes-Oxley Act was signed into law. The Sarbanes-Oxley Act represents a comprehensive revision of laws affecting corporate governance, accounting obligations and corporate reporting. The Sarbanes-Oxley Act is applicable to all companies with equity or debt securities registered under the Securities Exchange Act of 1934, as amended. In particular, the Sarbanes-Oxley Act established: (i) new requirements for audit committees, including independence, expertise, and responsibilities; (ii) additional responsibilities regarding financial statements for the Chief Executive Officer and Chief Financial Officer of the reporting company; (iii) new standards for auditors and regulation of audits; (iv) increased disclosure and reporting obligations for the reporting company and its directors and executive officers; and (v) new and increased civil and criminal penalties for violation of the securities laws. The most significant expense associated with compliance with the Sarbanes-Oxley Act has been the internal control documentation and attestation requirements of Section 404 of the Act. The Company's incremental external costs associated with complying with Section 404 of the Sarbanes-Oxley Act amounted to approximately $832,000 in 2005, the initial year of required compliance, with the external cost declining to approximately $200,000-$300,000 in each subsequent year as the Company gained efficiencies. The incremental costs relate to higher external audit fees and outside consultant fees. These amounts do not include the value of the significant internal resources devoted to compliance.

U.S. Treasury Capital Purchase Program

On October 3, 2008, in response to the financial crises affecting the banking system and financial markets and going concern threats to investment banks and other financial institutions, the Emergency Economic Stabilization Act of 2008 (the "EESA") was signed into law. Pursuant to the EESA, the U.S. Treasury was given the authority to, among other things, purchase up to $700 billion of mortgages, mortgage-backed securities and certain other financial instruments from financial institutions for the purpose of stabilizing and providing liquidity to the U.S. financial markets.

On October 14, 2008, the Secretary of the U.S. Department of the Treasury announced that the Treasury would purchase equity stakes in a wide variety of banks and thrifts. Under the program, known as the Capital Purchase Program, from the $700 billion authorized by the EESA, the Treasury made $250 billion of capital available to U.S. financial institutions in the form of purchases of preferred stock. In addition to the preferred stock, the Treasury received, from participating financial institutions, warrants to purchase common stock with an aggregate market price equal to 15% of the preferred investment. Participating financial institutions were required to adopt the Treasury's standards for executive compensation and corporate governance for the period during which the Treasury holds equity issued under the Capital Purchase Program.

Although we believed that our capital position was sound, we concluded that the Capital Purchase Program would allow us to raise additional capital on favorable terms in comparison with other available alternatives. Accordingly, we applied to participate in the Capital Purchase Program. The Treasury approved our application in December 2008, and we received $65 million in proceeds from the sale of 65,000 shares of cumulative perpetual preferred stock with a liquidation value of $1,000 per share to the Treasury on January 9, 2009. The preferred stock issued to the Treasury pays a dividend of 5% for the first five years and 9% thereafter. As part of the transaction, we also granted the Treasury a ten-year warrant to purchase up to 616,308 shares of our common stock at an exercise price of $15.82.

Table of Contents

Under the terms of the Capital Purchase Program, the Treasury's consent will be required for any increase in our dividends paid to common stockholders (above a quarterly dividend of $0.19 per common share) or the Company's redemption, purchase or acquisition of common stock or any trust preferred securities issued by the Company's capital trusts until the third anniversary of the senior preferred share issuance to the Treasury unless prior to such third anniversary the senior preferred shares are redeemed in whole or the Treasury has transferred all of these shares to third parties.

Participants in the Capital Purchase Program were required to accept several compensation-related limitations associated with this Program. In January 2009, each of our senior executive officers agreed in writing to accept the compensation standards in existence at that time under the Capital Purchase Program and thereby cap or eliminate some of their contractual or legal rights. The provisions agreed to were as follows:

No Golden Parachute Payments. For purposes of the Capital Purchase Program, "golden parachute payment" was defined to mean a severance payment resulting from involuntary termination of employment or from a bankruptcy event of the employer, which exceeds three times the terminated employee's average annual base salary over the five years prior to termination. Our senior executive officers have agreed to forego all golden parachute payments for as long as two conditions remain true: they remain "senior executive officers" (CEO, CFO and the next three highest-paid executive officers), and the Treasury continues to hold our equity or debt securities issued under the Capital Purchase Program. The period during which the Treasury holds those securities is the "Capital Purchase Program Covered Period."

Recovery of Incentive Compensation if Based on Certain Material Inaccuracies. Our senior executive officers have also agreed to a "clawback provision," which means that we can recover incentive compensation paid during the Capital Purchase Program Covered Period that is later found to have been paid based on materially inaccurate financial statements or other materially inaccurate measurements of performance.

No Compensation Arrangements That Encourage Excessive Risks. During the Capital Purchase Program Covered Period, we are not allowed to enter into compensation arrangements that encourage senior executive officers to take "unnecessary and excessive risks that threaten the value" of our company. To make sure this does not happen, the Company's Compensation Committee is required to meet at least once a year with our senior risk officers to review our executive compensation arrangements in light of our risk management policies and practices. Our senior executive officers' written agreements include their obligation to accept any changes in our incentive compensation arrangements resulting from the Compensation Committee's review.

Limit on Federal Income Tax Deductions. During the Capital Purchase Program Covered Period, we are not allowed to take federal income tax deductions for compensation paid to senior executive officers in excess of $500,000 per year, with certain exceptions that do not apply to our senior executive officers.

On February 17, 2009, President Obama signed the American Recovery and Reinvestment Act of 2009 (the "Stimulus Act") into law. The Stimulus Act modified the compensation-related limitations contained in the Capital Purchase Program and created additional compensation-related limitations. The limitations in the Stimulus Act apply to all participants in the Troubled Asset Relief Program (under which the Capital Purchase Program was created), regardless of when participation commenced. Thus, the newly enacted compensation-related limitations are applicable to the Company, subject to the Treasury Department's issuance of implementing regulations. The compensation-related limitations applicable to the Company which have been added or modified by the Stimulus Act are as follows:

No Severance Payments. Under the Stimulus Act, the definition of "golden parachute" was expanded to include any severance payment resulting from termination of employment, except for payments for services performed or benefits accrued. In addition, the Stimulus Act expanded the group of employees to which such restrictions apply. Consequently, under the Stimulus Act, we are prohibited from making any severance payment

Table of Contents

to our “senior executive officers” (defined in the Stimulus Act as the five highest paid senior executive officers) and our next five most highly compensated employees during the Capital Purchase Program Covered Period.

Recovery of Incentive Compensation if Based on Certain Material Inaccuracies. The Stimulus Act also contains the “clawback provision” discussed above, but extends its application to our next 20 most highly compensated employees.

No Compensation Arrangements That Encourage Earnings Manipulation. In addition to the Capital Purchase Program prohibition on compensation arrangements that encourage unnecessary and excessive risk, the Stimulus Act prohibits us during the Capital Purchase Program Covered Period from entering into compensation arrangements that encourage manipulation of reported earnings to enhance the compensation of any of our employees.

Limit on Incentive Compensation. The Stimulus Act contains a provision that prohibits the payment or accrual of any bonus, retention award or incentive compensation to any of our senior executive officers during the Capital Purchase Program Covered Period, other than awards of long-term restricted stock that (i) do not fully vest during the Capital Purchase Program Covered Period, (ii) have a value not greater than one-third of the total annual compensation of the awardee and (iii) are subject to such other restrictions as determined by the Secretary of the Treasury. The prohibition on bonus, incentive compensation and retention awards does not preclude payments required under written employment contracts entered into on or prior to February 11, 2009.

Compensation and Human Resources Committee Functions. The Stimulus Act requires that our Compensation Committee be comprised solely of independent directors and that it meet at least semiannually to discuss and evaluate our employee compensation plans in light of an assessment of any risk posed to us from such compensation plans.

Compliance Certifications. The Stimulus Act also requires a written certification by our Chief Executive Officer and Chief Financial Officer of our compliance with the provisions of the Stimulus Act. In the future, these certifications will be contained in our Annual Report on Form 10-K.

Treasury Review of Excessive Bonuses Previously Paid. The Stimulus Act directs the Secretary of the Treasury to review all compensation paid to our senior executive officers and the next 20 most highly compensated employees prior to adoption of the Stimulus Act to determine whether any such payments were inconsistent with the purposes of the Capital Purchase Program or the Stimulus Act or were otherwise contrary to the public interest. If the Secretary of the Treasury makes such a finding, the Secretary of the Treasury is directed to negotiate with the Capital Purchase Program recipient and the employee recipient for appropriate reimbursements to the federal government with respect to the compensation.

Say on Pay. Under the Stimulus Act, during the Capital Purchase Program Covered Period, we must include in the proxy statement for our annual meeting of shareholders a non-binding say on pay vote by the shareholders on executive compensation.

Limitation on Luxury Expenditures. The Stimulus Act requires us to adopt a company-wide policy regarding excessive or luxury expenditures, such as entertainment expenses, office or facility renovation expenses and transportation services expenses.

Supervision and Regulation of the Bank

Federal banking regulations applicable to all depository financial institutions, among other things: (i) provide federal bank regulatory agencies with powers to prevent unsafe and unsound banking practices; (ii) restrict preferential loans by banks to “insiders” of banks; (iii) require banks to keep information on loans to major shareholders and executive officers and (iv) bar certain director and officer interlocks between financial

13

Table of Contents

institutions.

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

The dividends that may be paid by the Bank to the Company are subject to legal limitations under North Carolina law. In addition, regulatory authorities may restrict dividends that may be paid by the Bank or the Company's other subsidiaries. The ability of the Company to pay dividends to its shareholders is largely dependent on the dividends paid to the Company by the Bank.

The Bank is a member of the FDIC, which currently insures the deposits of member banks. For this protection, each member bank pays a quarterly statutory assessment, based on its level of deposits, and is subject to the rules and regulations of the FDIC. For 2005 and 2006, due to the funded status of the insurance fund, the FDIC did not assess the Bank any insurance premiums. However, in late 2006 the FDIC adopted new regulations that resulted in all financial institutions, including the Bank, being assessed deposit insurance premiums ranging from 5 cents to 43 cents per $100 of assessable deposits beginning in 2007. The amount of the assessment within that range is based on risk factors that have been established by the FDIC. Based on the specified risk factors, for 2007 and 2008, the Bank was assigned an assessment rate of 5.1 cents per $100 of assessable deposits, which resulted in annual insurance premium expense to the Bank of approximately $932,000. However, as part of the 2006 legislation that created the new assessment schedule, the rules provided credits to certain institutions that paid deposit insurance premiums in years prior to 1996. As a result, the Bank received a one-time credit of $832,000 that was used to offset FDIC insurance premiums in 2007, which left the Bank with an actual expense of $100,000 in 2007. The Bank had no credit to apply in 2008, and the Company incurred approximately $1.2 million in deposit insurance premium expense during 2008.

On December 16, 2008, the FDIC raised the deposit insurance assessment rates uniformly for all institutions by 7 cents for every $100 of domestic deposits effective for the first quarter of 2009. On February 27, 2009, the FDIC announced that, commencing in April 2009, its minimum rates would increase to a range of twelve cents to sixteen cents per $100 in deposits. Excluding the special assessment discussed below, we estimate that our annual FDIC insurance premium expense will be approximately $3.0 million in 2009, a $1.8 million increase from 2008, as a result of the rate changes.

The FDIC also announced on February 27, 2009 an interim rule that would impose a one-time special assessment of twenty cents per $100 in insured deposits to be collected on September 30, 2009. Unless there are changes to the final rule, we estimate that our one-time special assessment will total approximately $4 million. The interim rule would also permit the FDIC to impose emergency special assessments from time to time after June 30, 2009 if the FDIC board believes the reserve fund will fall to a level that would adversely affect public confidence in federal deposit insurance.

In addition to deposit insurance assessments, the FDIC is authorized to collect assessments against insured deposits to be paid to the Finance Corporation (FICO) to service FICO debt incurred in connection with the resolution of the thrift industry crisis the 1980s. The FICO assessment rate is adjusted quarterly. The average annual assessment rate in 2008 was 1.12 cents per $100 for insured deposits, which resulted in approximately $218,000 in expense for the Bank for 2008. For the first quarter of 2009, the FICO assessment rate for such deposits will increase to 1.14 cents per $100 of insured deposits, which would result in annual expense of approximately $231,000 in 2009.

Table of Contents

Pursuant to the Emergency Economic Stabilization Act of 2008, the maximum deposit insurance amount per depositor has been increased from $100,000 to $250,000 until December 31, 2009. Additionally, on October 14, 2008, after receiving recommendations from the boards of the FDIC and the Federal Reserve, and consulting with the President, the Secretary of the Treasury signed the systemic risk exception to the FDIC Act, enabling the FDIC to establish its Temporary Liquidity Guarantee Program (“TLGP”). Under the transaction account guarantee program of the TLGP, the FDIC will fully guarantee, until the end of 2009, all non-interest-bearing transaction accounts, including NOW accounts with interest rates of 0.5 percent or less and IOLTAs (lawyer trust accounts). The TLGP also guarantees certain senior unsecured debt of insured depository institutions or their qualified holding companies issued between October 14, 2008 and June 30, 2009 with a stated maturity greater than 30 days. All eligible institutions were permitted to participate in both of the components of the TLGP without cost for the first 30 days of the program. Following the initial 30 day grace period, institutions were assessed at the rate of 10 basis points for account balances in excess of $250,000 in non-interest bearing transaction accounts for the transaction account guarantee program and at the rate of either 50, 75, or 100 basis points of the amount of debt issued, depending on the maturity date of the guaranteed debt, for the debt guarantee program. In December 2008, we elected to continue to participate in both programs. We do not expect the costs of the transaction account guarantee program or debt guarantee program to be significant.

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

Given the ongoing financial crisis and the new presidential administration, legislation that would affect regulation in the banking industry is introduced in most legislative sessions. Neither the Company nor the Bank can predict what other legislation might be enacted or what other regulations or assessments might be adopted, or if enacted or adopted, the effect thereof on the Bank’s operations.

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

Available Information

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

Table of Contents

Item 1A. Risk Factors

Difficult market conditions and economic trends have adversely affected our industry and our business.

Negative developments beginning in the latter half of 2007 and throughout 2008 in the sub-prime mortgage market and the securitization markets for such loans, together with substantial volatility in oil prices and other factors, have resulted in uncertainty in the financial markets in general and a related general economic downturn, continuing into 2009. Dramatic declines in the housing market, with decreasing home prices and increasing delinquencies and foreclosures, have negatively impacted the credit performance of mortgage and construction loans and resulted in significant write-downs of assets by many financial institutions. In addition, the value of real estate collateral supporting many loans has declined and may continue to decline. General downward economic trends, reduced availability of commercial credit and increasing unemployment have negatively impacted the credit performance of commercial and consumer credit, resulting in additional write-downs. We believe that the general economic downtrends are largely responsible for the deterioration in loan quality that we experienced in 2008, including higher levels of loan charge-offs, higher levels of nonperforming assets, and higher provisions for loan losses. Concerns over the stability of the financial markets and the economy have resulted in decreased lending by financial institutions to their customers and to each other. This market turmoil and tightening of credit has led to increased commercial and consumer delinquencies, lack of confidence, increased market volatility and widespread reduction in general business activity. Competition among depository institutions for deposits has increased significantly. Financial institutions, including us, have experienced a decrease in access to borrowings. The resulting economic pressure on consumers and businesses and the lack of confidence in the financial markets may adversely affect our business, financial condition, results of operations and stock price.

As a result of the foregoing factors, there is a potential for new federal or state laws and regulations regarding lending and funding practices and liquidity standards, and bank regulatory agencies are expected to be very aggressive in responding to concerns and trends identified in examinations. This increased governmental action may increase our costs and limit our ability to pursue certain business opportunities. As discussed previously, the FDIC has increased assessments to restore its deposit insurance funds. We may be required to pay even higher premiums to the FDIC because financial institution failures resulting from the depressed market conditions have nearly depleted and may continue to deplete the deposit insurance fund and reduce its ratio of reserves to insured deposits.

Our ability to assess the creditworthiness of customers and to estimate the losses inherent in our credit exposure is made more complex by these difficult market and economic conditions. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market and economic conditions on us, our customers and the other financial institutions in our market. As a result, we may experience additional increases in foreclosures, delinquencies and customer bankruptcies, as well as more restricted access to funds.

There can be no assurance that recent legislative and regulatory initiatives to address difficult market and economic conditions will stabilize the U.S. banking system.

The recently enacted Emergency Economic Stabilization Act of 2008, or EESA, authorizes the U.S. Treasury to, among other things, purchase up to $700 billion of mortgages, mortgage-backed securities and certain other financial instruments from financial institutions and their holding companies under a Troubled Asset Relief Program, or TARP. The purpose of the TARP is to restore confidence and stability to the U.S. banking system and to encourage financial institutions to increase their lending to customers and to each other. Under the TARP Capital Purchase Program, the U.S. Treasury is investing capital in qualified financial institutions in exchange for senior preferred stock and a warrant to purchase shares of equity securities of the financial institution. The EESA also increased federal deposit insurance on most deposit accounts from $100,000 to $250,000 until December 31, 2009.

16

Table of Contents

The EESA followed, and has been followed by, numerous actions by the Federal Reserve Board, the U.S. Congress, the U.S. Treasury, the FDIC, the SEC and other regulatory authorities seeking to address the current liquidity and credit crisis that followed the sub-prime mortgage market meltdown that began in 2007. These measures include homeowner relief that encourages loan restructuring and modification; the establishment of significant liquidity and credit facilities for financial institutions and investment banks; the lowering of the federal funds rate; emergency action against short selling practices; a temporary guaranty program for money market funds; the establishment of a commercial paper funding facility to provide back-stop liquidity to commercial paper issuers; and coordinated international efforts to address illiquidity and other weaknesses in the banking sector. The purpose of these legislative and regulatory actions is to stabilize the U.S. banking system.

The EESA and the other regulatory initiatives described above may not have their desired effects. If the volatility in the markets continues and economic conditions fail to improve or worsen, our business, financial condition and results of operations could be materially and adversely affected.

We are vulnerable to the economic conditions within the fairly small geographic region in which we operate.

Like many businesses, our overall success is partially dependent on the economic conditions in the marketplace where we operate. Our marketplace is predominately concentrated in the central Piedmont region of North Carolina. As is the case for most of the country, this region is currently experiencing recessionary economic conditions, which we believe is a factor in our increases in borrower delinquencies, nonperforming assets, and loan losses during 2008 compared to recent prior years. If economic conditions in our marketplace worsen, it could have an adverse impact on us. In particular, if economic conditions related to real estate values in our marketplace were to worsen, our loan losses would likely increase. At December 31, 2008, approximately 87% of our loans were secured by real estate collateral, which means that additional decreases in real estate values could have an adverse impact on our operations.

Current levels of unprecedented market volatility may adversely affect the market value of our common stock.

The capital and credit markets have been experiencing volatility and disruption for more than a year. In recent months, the volatility and disruption has reached unprecedented levels. In some cases, the markets have produced downward pressure on stock prices for certain companies without regard to those companies' underlying financial strength. We believe this is the case with our common stock as our stock price decreased from $18.35 at December 31, 2008 to levels as low as $6.87 in March 2009.

The market value of our stock may also be affected by conditions affecting the financial markets generally, including price and trading fluctuations. These conditions may result in (i) volatility in the level of, and fluctuations in, the market prices of stocks generally and, in turn, our stock and (ii) sales of substantial amounts of our stock in the market, in each case that could be unrelated or disproportionate to changes in our operating performance. These broad market fluctuations may adversely affect the market value of our stock.

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

Under generally accepted accounting principles, goodwill is required to be tested for impairment at least annually and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The test for goodwill impairment involves comparing the fair value of a company's reporting units to their respective carrying values. For our company, our community banking operation is our only material reporting unit. The price of our common stock is one of several measures available for estimating the fair value of our community banking operations. Since late

17

Table of Contents

February 2009, the stock market value of our common stock has traded below the book value of our company. Subject to the results of other valuation techniques, if this situation persists or worsens, this could indicate that our next test of goodwill will result in a determination that there is impairment. We may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill is determined, which could have a negative impact on our results of operations.

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

We are required to maintain adequate capital levels to support our operations. In the future, we might need to raise additional capital to support growth or absorb loan losses. Our access to capital markets (excluding the Capital Purchase Program) has lessened considerably in the last 12 to16 months, with very limited capital available to us, and any available capital being very expensive. Our ability to raise additional capital will depend on conditions in the capital markets at that time, which are outside our control, and on our financial performance. Accordingly, we cannot be certain of our ability to raise additional capital in the future if needed or on terms acceptable to us. If we cannot raise additional capital when needed, our ability to conduct our business could be materially impaired.

The soundness of other financial institutions could adversely affect us.

Since the middle of 2007, the financial services industry as a whole, as well as the securities markets generally, have been materially adversely affected by substantial declines in the values of nearly all asset classes and by a significant lack of liquidity. Financial institutions in particular have been subject to increased volatility and an overall loss in investor confidence. Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services companies are interrelated as result of trading, clearing, counterparty or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, and investment banks. Defaults by, or even rumors or questions about, one or more financial services companies, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. We can make no assurance that any such losses would not materially and adversely affect our business, financial condition or results of operations.

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

We are subject to extensive regulation and supervision from the North Carolina Commissioner of Banks, the FDIC, and the Federal Reserve Board. This regulation and supervision is intended primarily for the protection of the FDIC insurance fund and our depositors and borrowers, rather than for holders of our equity securities. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on operations, the classification of our assets and determination of the level of the allowance for loan losses. Changes in the regulations that apply to us, or changes in our compliance with regulations, could have a material impact on our operations.

Additionally, the documents that we executed with the Treasury when they purchased the Series A preferred stock allow the Treasury to unilaterally change the terms of the Series A preferred stock or impose additional requirements on us if there is a change in law. For example, the Stimulus Act imposed executive compensation restrictions that went beyond those imposed by the terms of the Capital Purchase Program. Additional changes or requirements could restrict our ability to conduct business, could subject us to additional cost and expense or could change the terms of the senior preferred stock agreement to the detriment of our common shareholders. While it may be possible for us to redeem the senior preferred stock in the event the Treasury imposes any changes or additional requirements that we believe are detrimental, there can be no assurances that our federal regulator will approve such redemption (as is required by law) or that we will have the ability to implement such

Table of Contents

redemption.

Because of our participation in the Capital Purchase Program, we are subject to restrictions on our ability to declare or pay dividends and repurchase our shares as well as restrictions on compensation paid to our executive officers.

Pursuant to the terms of the securities purchase agreement between our company and the U.S. Treasury, our ability to declare or pay dividends on any of our shares is limited. Specifically, we are unable to declare dividend payments on common stock if we are in arrears on the payment of dividends on the Series A preferred stock issued to the U.S. Treasury. Further, until January 9, 2012, we are not permitted to increase dividends on our common stock above the amount of the last quarterly cash dividend per share declared prior to October 14, 2008 ($0.19 per share) without the U.S. Treasury's approval unless all of the shares of Series A preferred stock have been redeemed or transferred by the U.S. Treasury to unaffiliated third parties.

In addition, our ability to repurchase our shares is restricted. The consent of the U.S. Treasury generally is required for us to make any stock repurchase (other than in connection with the administration of any employee benefit plan in the ordinary course of business and consistent with past practice) until January 9, 2012, unless all of the shares of Series A preferred stock have been redeemed or transferred by the U.S. Treasury to unaffiliated third parties. Further, we may not repurchase any shares of our common stock if we are in arrears on the payment of Series A preferred stock dividends.

In addition, pursuant to the terms of the securities purchase agreement between our company and the U.S. Treasury, we agreed to adhere to the U.S. Treasury's standards for executive compensation and corporate governance for the period during which the U.S. Treasury holds the equity securities issued pursuant to the agreement, including the shares of common stock which may be issued upon exercise of the warrant. The Emergency Economic Stabilization Act of 2008 that was signed into law on February 17, 2009 contains additional restrictions on executive compensation and standards of corporate governance that go beyond those in the securities purchase agreement. See the section above entitled "U.S. Treasury Capital Purchase Program" for additional discussion of this matter.

We face strong competition, which could hurt our business.

Our business operations are centered primarily in North Carolina, southwestern Virginia and northeastern South Carolina. Increased competition within this region may result in reduced loan originations and deposits. Ultimately, we may not be able to compete successfully against current and future competitors. Many competitors offer the types of loans and banking services that we offer. These competitors include savings associations, national banks, regional banks and other community banks. We also face competition from many other types of financial institutions, including finance companies, internet banks, brokerage firms, insurance companies, credit unions, mortgage banks and other financial intermediaries.

We compete in our market areas with several large interstate bank holding companies, which are headquartered or have significant operations in North Carolina. These large competitors have substantially greater resources than we have, including broader geographic markets, more banking locations, higher lending limits and the ability to make greater use of large-scale advertising and promotions. Also, these institutions, particularly to the extent they are more diversified than we are, may be able to offer the same products and services that we offer at more competitive rates and prices.

We also compete in some of our market areas with many banks that have been organized within the past ten years. These new banks often focus on loan and deposit balance sheet growth, and not necessarily on earnings profitability. This strategy often allows them to offer more attractive terms on loans and deposits than we are able to offer because we must achieve an acceptable level of profitability.

Moore County, North Carolina, which represents a disproportionate share of our deposits, is a particularly competitive market, with at least ten other financial institutions having a physical presence in the county, including both large interstate bank holding companies and recently organized banks.

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

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

Beginning in late 2007 and continuing throughout 2008, the Federal Reserve Board began reducing interest rates in response to unfavorable economic conditions in the United States economy. From September 2007 through December 2008, the Federal Reserve Board reduced interest rates by 500 basis points. When interest rates decline, most of our adjustable rate loans, which represent approximately 45% of all of our loans, reprice downwards immediately by the full amount of the rate cut. However, most of our interest expense relates to customer certificates of deposit, which cannot be repriced at lower interest rates until they mature. As a result, interest rate cuts negatively impact our profitability, particularly in the short-term. Additionally, given the sharp decline in interest rates, the interest rates we pay on our deposit accounts either cannot be repriced downwards by the full amount of the rate cut due to competitive pressures or because the rate is so close to zero already. Accordingly, our net interest margin declined during 2008 compared to 2007.

Based on prevailing economic forecasts that predict interest rates will remain relatively unchanged in 2009, we expect our profitability to be further negatively impacted during the early part of 2009 as a result of interest rate reductions that occurred late in 2008. The negative impact will continue until we are able to reprice maturing certificates of deposit at lower interest rates.

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

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

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

The value of our investment securities portfolio may be negatively affected by continued disruptions in the securities markets.

The market for some of the investment securities held in our portfolio has become volatile over the past twelve months. The continuing volatility of securities markets could detrimentally affect the value of our investment securities, including reduced valuations due to the perception of heightened credit and liquidity risks. We can make no assurance that declines in market value related to disruptions in the securities markets will not result in other than temporary impairment of these assets, which would lead to accounting charges that could have a material adverse effect on our net income and capital levels.

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

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

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

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

Although we have historically paid cash dividends, there is no assurance that we will continue to pay cash dividends. Future payment of cash dividends, if any, will be at the discretion of our board of directors and will be dependent upon our financial condition, results of operations, capital requirements, economic conditions, and such other factors as the board may deem relevant. As a result of their most recent consideration of these factors, on March 6, 2009, our board of directors declared a quarterly dividend of $0.08 per share, which was a decrease from the previous rate of $0.19 per share.

As a result of our participation in the Capital Purchase Program, the Treasury’s consent will be required for any dividends paid to common stockholders above a quarterly dividend rate of $0.19 per common share until January 9, 2012, unless prior to then the Series A preferred shares are redeemed in whole or the Treasury has transferred all of these shares to third parties. Also, in the event that we do not pay dividends due on the Series A preferred stock, we are prohibited from paying dividends on our common stock.

Item 1B. Unresolved Staff Comments

None

Table of Contents

Item 2. Properties

The main offices of the Company and the Bank are owned by the Bank and are located in a three-story building in the central business district of Troy, North Carolina. The building houses administrative and bank teller facilities. The Bank's Operations Division, including customer accounting functions, offices and operations of Montgomery Data, and offices for loan operations, are housed in two one-story steel frame buildings approximately one-half mile west of the main office. Both of these buildings are owned by the Bank. The Company operates 74 bank branches. The Company owns all of its bank branch premises except 11 branch offices for which the land and buildings are leased and three branch offices for which the land is leased but the building is owned. In addition, the Company leases one loan production office. There are no options to purchase or lease additional properties. The Company considers its facilities adequate to meet current needs and believes that lease renewals or replacement properties can be acquired as necessary to meet future needs.

Item 3. Legal Proceedings

Various legal proceedings may arise in the ordinary course of business and may be pending or threatened against the Company and its subsidiaries. However, neither the Company nor any of its subsidiaries is involved in any pending legal proceedings that management believes could have a material effect on the consolidated financial position of the Company.

There were no tax shelter penalties assessed by the Internal Revenue Service against the Company during the year ended December 31, 2008.

Item 4. Submission of Matters to a Vote of Shareholders

The following proposal was considered and acted upon at a special meeting of shareholders held on December 19, 2008:

A proposal to amend the articles of incorporation of the Company to authorize 5,000,000 shares of a new class of preferred stock, no par value.

For	8,660,114	Against	2,086,394	Abstain	111,632

PART II

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

The Company's common stock trades on The NASDAQ Global Select Market under the symbol FBNC. Table 22, included in "Management's Discussion and Analysis" below, sets forth the high and low market prices of the Company's common stock as traded by the brokerage firms that maintain a market in the Company's common stock and the dividends declared for the periods indicated. On March 6, 2009, the Company announced that because of the challenging economic environment and a desire to conserve capital, it would declare a cash dividend of $0.08 per share for the first quarter of 2009, which is a reduction from the previous dividend rate of $0.19 per share. For the foreseeable future, it is the Company's current intention to continue to pay cash dividends of $0.08 per share on a quarterly basis. Under the terms of the Company's participation in the U.S. Treasury's Capital Purchase Program, until January 9, 2012, the Company cannot declare a quarterly cash dividend exceeding $0.19 per share without the prior approval of the Treasury. See "Business - Supervision and Regulation" above and Note 15 to the consolidated financial statements for a discussion of other regulatory restrictions on the Company's payment of dividends. As of December

31, 2008, there were approximately 2,800 shareholders of record and another 4,000 shareholders whose stock is held in “street name.” There were no sales

22

Table of Contents

of unregistered securities during the year ended December 31, 2008.

Additional Information Regarding the Registrant's Equity Compensation Plans

At December 31, 2008, the Company had six equity-based compensation plans. Each of these plans is a stock option plan. Three of the six plans were assumed in corporate acquisitions. The Company's 2007 Equity Plan is the only one of the six plans for which new grants of stock options are possible.

The following table presents information as of December 31, 2008 regarding shares of the Company's stock that may be issued pursuant to the Company's equity based plans. The table does not include information with respect to shares subject to outstanding options granted under stock incentive plans assumed by the Company in connection with mergers and acquisitions of companies that originally granted those options. Footnote (2) to the table indicates the total number of shares of common stock issuable upon the exercise of options under the assumed plans as of December 31, 2008, and the weighted average exercise price of those options. No additional options may be granted under those assumed plans. At December 31, 2008, the Company had no warrants or stock appreciation rights outstanding.

	As of December 31, 2008		
	(a)	(b)	(c)
Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders (1)	758,495	$ 17.57	891,941
Equity compensation plans not approved by security holders			
Total (2)	758,495	$ 17.57	891,941

(1) Consists of (A) the Company's 2007 Equity Plan, which is currently in effect; (B) the Company's 2004 Stock Option Plan; and (C) the Company's 1994 Stock Option Plan, each of which was approved by our shareholders.

(2) The table does not include information for stock incentive plans that the Company assumed in connection with mergers and acquisitions of the companies that originally established those plans. As of December 31, 2008, a total of 70,381 shares of common stock were issuable upon exercise under those assumed plans. The weighted average exercise price of those outstanding options is $13.36 per share. No additional options may be granted under those assumed plans.

Table of Contents

Performance Graph

The performance graph shown below compares the Company's cumulative total return to shareholders for the five-year period commencing December 31, 2003 and ending December 31, 2008, with the cumulative total return of the Russell 2000 Index (reflecting overall stock market performance of small-capitalization companies), and an index of banks with between $1 billion and $5 billion in assets, as constructed by SNL Securities, LP (reflecting changes in banking industry stocks). The graph and table assume that $100 was invested on December 31, 2003 in each of the Company's common stock, the Russell 2000 Index, and the SNL Bank Index, and that all dividends were reinvested.

First Bancorp
Comparison of Five-Year Total Return Performances (1)
Five Years Ending December 31, 2008

	Total Return Index Values (1) December 31,					
	2003	2004	2005	2006	2007	2008
First Bancorp	$ 100.00	134.37	103.04	115.50	103.70	105.35
Russell 2000	100.00	118.33	123.72	146.44	144.15	95.44
SNL Index-Banks between $1 billion and $5 billion	100.00	123.42	121.31	140.38	102.26	84.84

Notes:

(1) Total return indices were provided from an independent source, SNL Securities LP, Charlottesville, Virginia, and assume initial investment of $100 on December 31, 2003, reinvestment of dividends, and changes in market values. Total return index numerical values used in this example are for illustrative purposes only.

Table of Contents

Issuer Purchases of Equity Securities

Pursuant to authorizations by the Company's board of directors, the Company has from time to time repurchased shares of common stock in private transactions and in open-market purchases. The most recent board authorization was announced on July 30, 2004 and authorized the repurchase of 375,000 shares of the Company's stock. The Company did not repurchase any shares of its common stock during the quarter ended December 31, 2008. Under the terms of the Company's participation in the U.S. Treasury's Capital Purchase Program, the Treasury's consent is required for any stock repurchases prior to January 9, 2012, unless the Company has redeemed the Series A preferred stock in whole, or the Treasury has transferred all of these shares to third parties.

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)
Month #1 (October 1, 2008 to October 31, 2008)				234,667
Month #2 (November 1, 2008 to November 30, 2008)				234,667
Month #3 (December 1, 2008 to December 31, 2008)				234,667
Total				234,667

Footnotes to the Above Table

(1) 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 Company's common stock. The repurchase authorization does not have an expiration date. Subject to the restrictions discussed above related to the Company's participation in the U.S. Treasury's Capital Purchase Program, there are no plans or programs the Company has determined to terminate prior to expiration, or under which the Company does not intend to make further purchases.

(2) The above table above does not include shares that were used by option holders to satisfy the exercise price of the call options issued by the Company to its employees and directors pursuant to the Company's stock option plans. In November 2008, a total of 14,876 shares of our common stock, with a weighted average market price of $17.99 per share, were used to satisfy an exercise of options.

Item 6. Selected Consolidated Financial Data

Table 1 on page 58 of this report sets forth the selected consolidated financial data for the Company.

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

Management's Discussion and Analysis is intended to assist readers in understanding our results of operations and changes in financial position for the past three years. This review should be read in conjunction with the consolidated financial statements and accompanying notes beginning on page 71 of this report and the supplemental financial data contained in Tables 1 through 22 included with this discussion and analysis.

Table of Contents

Overview - 2008 Compared to 2007

Net income was approximately 1% higher in 2008 than in 2007, while earnings per share were down 9% due to a higher number of shares of stock outstanding as a result of shares issued in connection with our acquisition of Great Pee Dee Bancorp, Inc. Overall our profitability measures were down in 2008 primarily as a result of a lower net interest margin, higher provision for loan losses, and higher expenses that were associated with our growth.

Financial Highlights ($ in thousands except per share data)		2008	2007	Change
Earnings				
Net interest income	$	86,559	79,284	9.2%
Provision for loan losses		9,880	5,217	89.4%
Noninterest income		21,107	18,473	14.3%
Noninterest expenses		62,661	57,580	8.8%
Income before income taxes		35,125	34,960	0.5%
Income tax expense		13,120	13,150	-0.2%
Net income	$	22,005	21,810	0.9%
Net income per share				
Basic	$	1.38	1.52	-9.2%
Diluted		1.37	1.51	-9.3%
At Year End				
Assets	$	2,750,567	2,317,249	18.7%
Loans		2,211,315	1,894,295	16.7%
Deposits		2,074,791	1,838,277	12.9%
Ratios				
Return on average assets		0.89%	1.02%	
Return on average equity		10.44%	12.77%	
Net interest margin (taxable-equivalent)		3.74%	4.00%	

The following is a more detailed discussion of our results for 2008 compared to 2007:

Net income for the year ended December 31, 2008 was $22,005,000, or $1.37 per diluted share, compared to net income of $21,810,000, or $1.51 per diluted share, reported for 2007, a decrease of 9.3% in earnings per share. The 2008 earnings reflect the impact of the acquisition of Great Pee Dee Bancorp, Inc. (Great Pee Dee), which had $211 million in total assets as of the acquisition date of April 1, 2008, and resulted in the issuance of 2,059,091 shares of First Bancorp common stock.

We experienced strong balance sheet growth in 2008. Total assets at December 31, 2008 amounted to $2.8 billion, 18.7% higher than a year earlier. Total loans at December 31, 2008 amounted to $2.2 billion, a 16.7% increase from a year earlier, and total deposits amounted to $2.1 billion at December 31, 2008, a 12.9% increase from a year earlier. Total shareholders’ equity amounted to $219.9 million at December 31, 2008, a 26.3% increase from a year earlier. The high growth rates were impacted by the acquisition of Great Pee Dee on April 1, 2008, which had $184 million in loans, $148 million in deposits, and $211 million in assets on that date.

Net interest income for the year ended December 31, 2008 amounted to $86.6 million, a 9.2% increase from 2007. The increases in net interest income during 2008 were primarily due to growth in loans and deposits. Also, subsequent to the Great Pee Dee acquisition in April 2008, we recorded non-cash net interest income purchase accounting adjustments totaling $1,098,000 for 2008, which increased net interest income. The largest of the adjustments relates to recording the Great Pee Dee time deposit portfolio at fair market value. This

Table of Contents

adjustment was $1.1 million and is being amortized to reduce interest expense over a total of eleven months, or $100,000 per month, until March 2009.

The impact of the growth in loans and deposits on net interest income was partially offset by a decline in our net interest margin (tax-equivalent net interest income divided by average earning assets). Our net interest margin for 2008 was 3.74% compared to 4.00% for 2007. Our net interest margin has been negatively impacted by the Federal Reserve lowering interest rates by a total of 500 basis points from September 2007 to December 2008. When interest rates are lowered, our net interest margin declines, at least temporarily, as most of our adjustable rate loans reprice downward immediately, while rates on our customer time deposits are fixed, and thus do not adjust downward until they mature.

Our provision for loan losses for the year ended December 31, 2008 was $9,880,000 compared to $5,217,000 recorded in 2007. The higher provision in 2008 is primarily related to negative trends in asset quality.

Although we have no exposure to the subprime mortgage market, the current economic environment has resulted in an increase in our delinquencies and classified assets. At December 31, 2008, our nonperforming assets were $35.4 million compared to $10.9 million at December 31, 2007. Our nonperforming assets to total assets ratio was 1.29% at December 31, 2008 compared to 0.47% at December 31, 2007. For the year ended December 31, 2008, our ratio of net charge-offs to average loans was 0.24% compared to 0.16% for 2007.

Although our asset quality ratios discussed above reflect unfavorable trends, they compare favorably to those typical of our peers based on public information available. The table below shows how our ratios compare to data reported by the Federal Reserve for all bank holding companies with between $1 billion and $3 billion in assets at December 31, 2008:

	First Bancorp	Peer Average
Nonaccrual loans and loans past due 90 days and still accruing as percent of total loans	1.20%	2.40%
Net charge-offs to average loans	0.24%	0.66%

Noninterest income for the year ended December 31, 2008 amounted to $21.1 million, a 14.3% increase over 2007. The positive variance in noninterest income for the twelve months ended December 31, 2008 primarily relates to increases in service charges on deposit accounts. These higher service charges were primarily associated with expanding the availability of our customer overdraft protection program in the fourth quarter of 2007 to include debit card purchases and ATM withdrawals. Previously the overdraft protection program, in which we charge a fee for honoring payments on overdrawn accounts, only applied to written checks.

Noninterest expenses for the year ended December 31, 2008 amounted to $62.7 million, an 8.8% increase from 2007. This increase is primarily attributable to our growth, including the April 1, 2008 acquisition of Great Pee Dee. Additionally, we recorded FDIC insurance expense of $1,157,000 for year ended December 31, 2008, compared to $100,000 for 2007, as a result of the FDIC recently beginning to charge for FDIC insurance again in order to replenish its reserves. We expect our FDIC insurance expense to be significantly higher in 2009 than 2008, and we also expect our pension plan expense to be significantly higher in 2009 – see "Outlook for 2009" below for discussion of the causes of these increases.

Our efficiency ratio (noninterest expense divided by the sum of tax-equivalent net interest income plus noninterest income – for this measure, a lower ratio is more favorable) was 57.85% for the year ended December 31, 2008 compared to 58.57% for 2007.

Our effective tax rate was 37%-38% for each of years ended December 31, 2008 and 2007.

Table of Contents

Overview - 2007 Compared to 2006

Net income was 13% higher in 2007 than in 2006. In 2006, a merchant credit card loss totaling $1.9 million or $0.08 per diluted share (after-tax), negatively impacted earnings. The positive impact on earnings from growth in loans and deposits during 2007 was partially offset by a lower net interest margin and higher expenses that were associated with our growth.

Financial Highlights ($ in thousands except per share data)	2007	2006	Change
Earnings			
Net interest income	$ 79,284	74,536	6.4%
Provision for loan losses	5,217	4,923	6.0%
Noninterest income	18,473	14,310	29.1%
Noninterest expenses	57,580	53,198	8.2%
Income before income taxes	34,960	30,725	13.8%
Income tax expense	13,150	11,423	15.1%
Net income	$ 21,810	19,302	13.0%
Net income per share			
Basic	$ 1.52	1.35	12.6%
Diluted	1.51	1.34	12.7%
At Year End			
Assets	$ 2,317,249	2,136,624	8.5%
Loans	1,894,295	1,740,396	8.8%
Deposits	1,838,277	1,695,679	8.4%
Ratios			
Return on average assets	1.02%	1.00%	
Return on average equity	12.77%	11.83%	
Net interest margin (taxable-equivalent)	4.00%	4.18%	

The following is a more detailed discussion of our results for 2007 compared to 2006:

Net income for the year ended December 31, 2007 amounted to $21,810,000, or $1.51 per diluted share, compared to net income of $19,302,000, or $1.34 per diluted share, reported for 2006. Results for 2006 include the write-off loss of a merchant credit card receivable amounting to $1,900,000, which had an after-tax impact of $1,149,000, or $0.08 per diluted share, on our earnings for 2006.

We experienced strong balance sheet growth in 2007. Total assets at December 31, 2007 amounted to $2.32 billion, 8.5% higher than a year earlier. Total loans at December 31, 2007 amounted to $1.89 billion, an increase of $154 million, or 8.8%, from a year earlier. Total deposits amounted to $1.84 billion at December 31, 2007, an increase of $143 million, or 8.4%. All of the loan and deposit growth was internally-generated, as there were no acquisitions that were completed during 2007. Total shareholders’ equity amounted to $174.1 million at December 31, 2007, a 7.0% increase from a year earlier.

The growth in loans and deposits was the primary reason for the increase in our net interest income when comparing 2007 to 2006. Net interest income for the year ended December 31, 2007 amounted to $79.3 million, a 6.4% increase over the $74.5 million recorded in 2006.

The impact of the growth in loans and deposits on our net interest income was partially offset by a decline in our net interest margin (tax-equivalent net interest income divided by average earning assets), as discussed below. Our net interest margin for the year ended December 31, 2007 was 4.00% compared to 4.18% for 2006.

Table of Contents

For the first three quarters of 2007, the lower net interest margins realized in 2007 compared to 2006 were caused primarily by the deposit rates we paid rising by more than loan and investment yields, which was associated with the flat interest rate yield curve that was prevailing in the marketplace. We were also negatively impacted during the first three quarters of 2007 by customers shifting their funds from low cost deposits to higher cost deposits as rates rose. In the fourth quarter of 2007, our net interest margin was negatively impacted by the Federal Reserve lowering interest rates by a total of 100 basis points during the last four months of the year.

Our provision for loan losses did not vary significantly when comparing 2007 to 2006. The provision for loan losses for the year ended December 31, 2007 was $5,217,000 compared to $4,923,000 for 2006. Asset quality changes and loan growth are the most significant factors that impact our provision for loan losses. Generally in 2007, the impact of unfavorable asset quality trends on our provision for loan losses was largely offset by lower loan growth experienced during the year compared to 2006. Our net charge-offs to average loans ratio was 0.16% for the year ended December 31, 2007 compared to 0.11% in 2006, while the ratio of nonperforming assets to total assets was 0.47% at December 31, 2007 compared to 0.39% a year earlier. Net internal loan growth for 2007 was $154 million compared to $252 million for 2006.

Noninterest income for the year ended December 31, 2007 amounted to $18,473,000, an increase of 29.1% from the $14,310,000 recorded in 2006. The positive variance in noninterest income for 2007 compared to 2006 was significantly impacted by a $1.9 million merchant credit card loss that we reserved for in the second and third quarters of 2006. Another reason for the increase in 2007 compared to 2006 was the expansion of our overdraft protection program in the fourth quarter of 2007 to include overdraft protection for debit card purchases and ATM withdrawals. Previously the overdraft protection program, in which we charge a fee for honoring payments on overdrawn accounts, only applied to written checks. This change resulted in an increase in service charges on deposit accounts.

Noninterest expenses for 2007 amounted to $57.6 million, an 8.2% increase from the $53.2 million recorded in 2006. The increase in noninterest expenses is primarily attributable to costs associated with our overall growth in loans, deposits and branch network. From October 1, 2006 to December 31, 2007, we opened six full service bank branches. Although noninterest expenses rose in 2007, the lower rate of increase compared to 2006 was partially due to the implementation of cost control recommendations that arose from a performance improvement consulting project that we completed in the first quarter of 2007. In addition, subsequent to the completion of the consulting project, we took further measures to contain costs and improve efficiency. As a result, our number of full-time equivalent employees decreased by six during 2007.

Our efficiency ratio (noninterest expense divided by the sum of tax-equivalent net interest income plus noninterest income – for this measure, a lower ratio is more favorable) was 58.57% for the year ended December 31, 2007 compared to 59.54% for 2006.

During both 2006 and 2007, our effective tax rate was approximately 37%.

Outlook for 2009

The banking industry is facing significant challenges in 2009. The nation is in the midst of a recession with the economic data getting seemingly worse with each passing day. What began with heavy losses in the sub-prime mortgage market (which we had no exposure to) expanded to become a decline in the overall housing market, which is having a pervasive effect on most aspects of our economy. This is resulting in higher loan losses for banks, and bank failures are occurring on a regular basis. The bank failures are depleting the FDIC insurance fund, which is requiring the FDIC to raise insurance premiums. Additionally, on February 27, 2009 the FDIC issued an interim rule requiring a special one-time assessment that, if approved in its current form, will have a significant impact on most banks, including our company.

Although we have consistently operated our company in what we believe is a conservative manner and have asset quality ratios that compare favorably to peer ratios, we are not immune to the challenges facing the industry. For 2009, based on the unfavorable economic conditions that we expect to prevail throughout 2009 and our expectation that loan growth will be in a range of 0%-2%, we currently project that it will be necessary to record provisions for loan losses at approximately the rate recorded in the second half of 2008. In the second half of 2008, we recorded provisions for loan losses of $6.3 million. If our 2009 provision for loan losses were to total $12 million, which would represent a $2.1 million, or 21%, increase from 2008, this would negatively impact our after-tax earnings per share by $0.08 compared to 2008 (assuming a constant number of shares outstanding during the year).

We also expect significant unfavorable variances in two of our categories of noninterest expenses – FDIC insurance expense and pension expense.

As noted above, the FDIC has announced increases in its annual insurance premium rates. Based on the FDIC's guidance, excluding the special assessment discussed below, we expect our annual FDIC insurance premium expense will be approximately $3.0 million in 2009, a $1.8 million increase from 2008, which is expected to negatively impact our after-tax earnings per share by $0.07 compared to 2008.

Additionally, the FDIC announced on February 27, 2009 an interim rule that would impose a one-time special assessment of 20 cents per $100 in insured deposits, to be collected in the third quarter of 2009. If approved as proposed, we estimate that our special assessment will total approximately $4 million, or $0.15 per share on an after-tax basis.

We also expect our pension expense will be significantly higher in 2009 compared to 2008. This is primarily due to investment losses experienced in our pension plan trust account as a result of the decline in the stock market. Based on a preliminary report from our third-party actuary, we expect our pension expense to increase from $2.3 million in 2008 to $3.6 million in 2009, an increase of $1.3 million, or $0.05 per share on an after-tax basis.

Finally, as discussed above under "U.S. Treasury Capital Purchase Program," we sold $65 million in preferred stock and warrants to the U.S. Treasury on January 9, 2009. The preferred stock carries a dividend rate of 5% for the first five years, which is not tax deductible. With the low loan demand we are currently experiencing and the low investment rates available in the marketplace for safe securities, we expect to earn substantially less on the $65 million than we will be paying in dividends. Based on our projected use of these proceeds in light of the current conditions, we expect that we will earn $3.3 million less on an after-tax basis, or $0.20 per share of common stock, than the cost of the preferred stock.

The sum of the expected earnings per share impact on our common shareholders related to the factors discussed above is a decrease of $0.55. All per share calculations in this section assume that the number of shares outstanding remains constant throughout the year.

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 and intangible assets are two 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

Table of Contents

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 loans defined as "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. 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. First, loans that we have risk graded as having more than "standard" risk but are not considered to be impaired are assigned estimated loss percentages generally accepted in the banking industry. Loans that we have classified as having normal credit risk are segregated by loan type, and estimated loss percentages are assigned to each loan type based on the historical losses, current economic conditions, and operational conditions specific to each loan type.

The reserve estimated for impaired loans is then added to the reserve estimated for all other loans. This becomes our "allocated allowance." In addition to the allocated allowance derived from the model, we also evaluate other data such as the ratio of the allowance for loan losses to total loans, net loan growth information, nonperforming asset levels and trends in such data. Based on this additional analysis, we may determine that an additional amount of allowance for loan losses is necessary to reserve for probable losses. This additional amount, if any, is our "unallocated allowance." The sum of the allocated allowance and the unallocated allowance is compared to the actual allowance for loan losses recorded on our books and any adjustment necessary for the recorded allowance to equal the computed allowance is recorded as a provision for loan losses. The provision for loan losses is a direct charge to earnings in the period recorded.

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 "Allowance for Loan Losses and Loan Loss Experience" below.

Intangible Assets

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

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

Table of Contents

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, we evaluate goodwill 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). At our last evaluation, the fair value of our community banking operation exceeded its carrying value, including goodwill. 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.

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.

Merger and Acquisition Activity

We completed the following acquisitions during 2006 and 2008 (none in 2007). The results of each acquired company/branch are included in our financial statements beginning on their respective acquisition dates.

(a) On July 7, 2006, we completed the purchase of a branch of First Citizens Bank located in Dublin, Virginia. We assumed the branch's $21 million in deposits and did not purchase any loans in this transaction. The primary reason for this acquisition was to increase our presence in southwestern Virginia, a market in which we already had three branches with a large customer base. We paid a deposit premium for the branch of approximately $994,000, all of which is deductible for tax purposes. The identifiable intangible asset associated with the fair value of the core deposit base, as determined by an independent consulting firm, was determined to be $269,000 and is being amortized as expense on an accelerated basis over an eight year period based on an amortization schedule provided by the consulting firm. The weighted-average amortization period is approximately 2.2 years. The remaining intangible asset of $725,000 has been classified as goodwill, and thus is not being systematically amortized, but rather is subject to an annual impairment test. The primary factor that contributed to a purchase price that resulted in recognition of goodwill was our desire to expand our presence in southwestern Virginia with facilities, operations and experienced staff in place. This branch's operations are included in the accompanying Consolidated Statements of Income beginning on the acquisition date of July 7, 2006.

(b) On September 1, 2006, we completed the purchase of a branch of Bank of the Carolinas in Carthage, North Carolina. We assumed the branch's $24 million in deposits and $6 million in loans. The primary reason

Table of Contents

for this acquisition was to increase our presence in Moore County, a market in which we already had ten branches with a large customer base. We paid a deposit premium for the branch of approximately $1,768,000, all of which is deductible for tax purposes. The identifiable intangible asset associated with the fair value of the core deposit base, as determined by an independent consulting firm, was determined to be approximately $235,000 and is being amortized as expense on an accelerated basis over a thirteen year period based on an amortization schedule provided by the consulting firm. The weighted-average amortization period is approximately 3.2 years. The remaining intangible asset of $1,533,000 has been classified as goodwill, and thus is not being systematically amortized, but rather is subject to an annual impairment test. The primary factor that contributed to a purchase price that resulted in recognition of goodwill was our desire to expand in an existing high-growth market with facilities, operations and experienced staff in place. This branch's operations are included in the accompanying Consolidated Statements of Income beginning on the acquisition date of September 1, 2006.

(c) On April 1, 2008, we completed the acquisition of Great Pee Dee Bancorp, Inc. (Great Pee Dee). Great Pee Dee was the parent company of Sentry Bank and Trust (Sentry), a South Carolina community bank with one branch in Florence, South Carolina and two branches in Cheraw, South Carolina. Great Pee Dee had $211 million in total assets as of the date of acquisition. This acquisition represented a natural extension of our market area with Sentry's Cheraw offices being in close proximity to our Rockingham, North Carolina branch and Sentry's Florence office being in close proximity to our existing branches in Dillon and Latta, South Carolina. Our primary reason for the acquisition was to expand into a contiguous market with facilities, operations and experienced staff in place. The terms of the agreement called for shareholders of Great Pee Dee to receive 1.15 shares of First Bancorp stock for each share of Great Pee Dee stock they owned. The transaction was completed on April 1, 2008 and resulted in the issuance of 2,059,091 shares of our common stock that were valued at approximately $37.0 million and the assumption of employee stock options with a fair market value of approximately $0.6 million. The value of the stock issued was determined using a Company stock price of $17.98, which was the average of the daily closing price of our stock for the five trading days closest to the July 12, 2007 announcement of the execution of the definitive merger agreement. The value of the employee stock options assumed was determined using the Black-Scholes option-pricing model. The operating results of Great Pee Dee are included in our financial statements for the year ended December 31, 2008 beginning on the April 1, 2008 acquisition date.

As a result of this acquisition, we recorded approximately $847,000 in an intangible asset related to the core deposit base that is being amortized on a straight-line basis over the weighted average life of the core deposit base, which was estimated to be 7.4 years. Additionally, we recorded approximately $16,330,000 in goodwill that is not being systematically amortized, but rather is subject to an annual impairment test. We agreed to a purchase price that resulted in recognition of goodwill primarily due to the reasons noted above, as well as the generally positive earnings of Great Pee Dee.

See Note 2 and Note 6 to the consolidated financial statements for additional information regarding intangible assets.

Table of Contents

ANALYSIS OF RESULTS OF OPERATIONS

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

Net Interest Income

Net interest income on a reported basis amounted to $86,559,000 in 2008, $79,284,000 in 2007, and $74,536,000 in 2006. For internal purposes and in the discussion that follows, we evaluate our net interest income on a tax-equivalent basis by adding the tax benefit realized from tax-exempt securities to reported interest income. Net interest income on a tax-equivalent basis amounted to $87,217,000 in 2008, $79,838,000 in 2007, and $75,037,000 in 2006. Management believes that analysis of net interest income on a tax-equivalent basis is useful and appropriate because it allows a comparison of net interest amounts in different periods without taking into account the different mix of taxable versus non-taxable investments that may have existed during those periods. The following is a reconciliation of reported net interest income to tax-equivalent net interest income.

		Year ended December 31,		
($ in thousands)		2008	2007	2006
Net interest income, as reported	$	86,559	79,284	74,536
Tax-equivalent adjustment		658	554	501
Net interest income, tax-equivalent	$	87,217	79,838	75,037

Table 2 analyzes net interest income on a tax-equivalent basis. Our net interest income on a taxable-equivalent basis increased by 9.2% in 2008 and 6.4% in 2007. There are two primary factors that cause changes in the amount of net interest income we record - 1) growth in loans and deposits, and 2) our net interest margin (tax-equivalent net interest income divided by average interest-earning assets). In 2007 and 2008, growth in loans and deposits increased net interest income, the positive effects of which were partially offset by lower net interest margins realized in each year. Additionally, subsequent to the Great Pee Dee acquisition in April 2008, we recorded non-cash net interest income purchase accounting adjustments totaling $1,098,000 for 2008, which increased net interest income. The largest of the adjustments relates to recording the Great Pee Dee time deposit portfolio at fair market value. This adjustment was $1.1 million and is being amortized to reduce interest expense over a total of eleven months, or $100,000 per month, until March 2009.

Loans outstanding grew by 16.7% and 8.8% in 2008 and 2007, respectively, while deposits increased 12.9% in 2008 and 8.4% in 2007. A majority of the increase in loans and deposits in 2008 came as a result of the April 1, 2008 acquisition of Great Pee Dee, which had $184 million in loans and $148 million in deposits. See additional discussion regarding the nature of the growth in loans and deposits in the section entitled “Analysis of Financial Condition and Changes in Financial Condition” below.

As illustrated in Table 3, this growth positively impacted net interest income in both 2008 and 2007. In both years, the positive impact on net interest income of growth in interest-earning assets, primarily loans, more than offset the higher interest expense associated with funding the asset growth. In 2008, growth in interest-earning asset volumes resulted in an increase in interest income of $23.2 million, while growth in interest-bearing liabilities only resulted in $11.6 million in higher interest expense. In 2007, growth in interest-earning asset volumes resulted in an increase in interest income of $15.1 million, while growth in interest-bearing liabilities only resulted in $8.0 million in higher interest expense. As a result, balance sheet growth resulted in an increase in tax-equivalent net interest income of

$11.6 million in 2008 and $7.0 million in 2007.

Table of Contents

Table 3 also illustrates the impact that changes in the rates that we earned/paid had on our net interest income in 2007 and 2008. During 2007, the prevailing interest rate environment was, on average, generally higher than that of 2006. These higher interest rates resulted in an increase in interest expense of $6.9 million during 2007 compared to an increase in interest income of only $4.7 million, which resulted in a reduction in net interest income of $2.2 million. Beginning in late 2007 and throughout 2008, the Federal Reserve reduced interest rates significantly as a result of recessionary economic conditions. The lower interest rates resulted in a decrease in our interest income of $24.2 million compared to a decrease in interest expense of only $19.9 million, which resulted in a reduction in net interest income of $4.2 million. Thus the declining interest rates negatively impacted net interest income. See below for additional discussion of the reasons that the higher rates in 2007 and the lower rates in 2008 both negatively impacted net interest income.

We measure the spread between the yield on our earning assets and the cost of our funding primarily in terms of the ratio entitled “net interest margin” which is defined as tax-equivalent net interest income divided by average earning assets. Our net interest margin decreased in both 2008 and 2007, amounting to 3.74% in 2008, 4.00% in 2007, and 4.18% in 2006.

The decline in our net interest margin in 2007 compared to 2006 was primarily associated with the flattening of the yield curve that began in 2006 and prevailed throughout 2007. The term “yield curve” refers to the difference between short-term interest rates and long-term interest rates, with a “flat yield curve” referring to a period when short term-interest rates and long-term interest rates are substantially the same. A flat yield curve is unfavorable for us because our funding costs are generally tied to short-term interest rates, while our investment returns on securities and loans are more closely correlated to longer-term interest rates. When short-term and long-term interest rates converge, the interest rate spread that we are able to earn is reduced and our net interest margin and profitability are unfavorably impacted. Due largely to the progressive flattening of the yield curve that occurred throughout 2006, our net interest margin decreased throughout 2006 before stabilizing at the lower levels in 2007 as a result of the relatively stable interest rate environment in effect for most of 2007.

In 2008, our lower net interest margin was caused primarily by the significant decreases in interest rates that the Federal Reserve announced beginning in late 2007 and that continued throughout 2008. From September 2007 to December 2008, the Federal Reserve reduced interest rates by a total of 500 basis points. When interest rates are lowered, our net interest margin declines, at least temporarily, because generally our assets that reprice when interest rates change reprice downward immediately by the full amount of the interest rate change, while most of our 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. Also, for many of our deposit products, including time deposits that have recently matured, we were unable to lower the interest rates we pay our customers by the full 500 basis point interest rate decrease due to competitive pressures. Also, many of our deposit accounts had rates lower than 5.00% prior to the rate cuts, and thus could not be reduced by 500 basis points. See additional discussion in “Interest Rate Risk” below.

In addition to the negative effects mentioned above, our net interest margin in the past two years has been negatively impacted by our deposit growth being concentrated in deposit account types that carry high interest rates. In 2008, we offered higher interest rates on several of our deposit products in order to attract deposits and enhance our liquidity, which was negatively impacted by our acquisition of Great Pee Dee Bancorp, which had $184 million in loans and only $148 million in deposits. In 2007, we offered higher rates on these products to attract more deposits in order to fund high loan growth.

For the reasons discussed above, the yields we realized on our interest-earning assets decreased by a larger amount than did the rates we paid on our interest-bearing liabilities during 2008, while in 2007 the yields we realized on our interest-earning assets increased by a smaller amount than did the rates we paid on our interest-bearing liabilities. As derived from Table 2, in comparing 2008 to 2007, the yield realized on average earning assets decreased by 110 basis points (from 7.48% to 6.38%) while the average rate paid on interest-bearing liabilities decreased by only 100 basis points (from 4.04% to 3.04%). In comparing 2007 to 2006, the yield realized on average earning assets increased by only 25 basis points (from 7.23% to 7.48%) while the average

Table of Contents

rate paid on interest-bearing liabilities increased by 48 basis points (from 3.56% to 4.04%). The differences in these changes in both 2007 and 2008 negatively impacted our net interest margin.

Beginning in 2005, we gradually repositioned the company's interest rate risk profile to be less susceptible to unfavorable change in a declining interest rate environment. At that time our loan portfolio was comprised of 60% adjustable rate loans, which are unfavorable in a declining interest rate environment. Since that time, by gradually originating more fixed rate loans than adjustable rate loans, our loan portfolio was comprised of only 45% adjustable rate loans at December 31, 2008. In addition, as rates declined in late 2007 and throughout 2008, we started an initiative to add interest rate floors to our adjustable rate loans. At December 31, 2008, adjustable rate loans totaling $411 million had reached their contractual floors and no longer subjected us to risk in the event of further rate cuts. These two factors lessened the unfavorable impact of the interest rate declines discussed above.

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

Provision for Loan Losses

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

Our provision for loan losses was $9,880,000 in 2008, compared to $5,217,000 in 2007 and $4,923,000 in 2006. Asset quality changes and loan growth are the most significant factors that impact our provision for loan losses. The higher loss provision in 2008 was due to negative trends in asset quality. In 2007, the impact of unfavorable asset quality trends on our provision for loan losses was largely offset by lower loan growth experienced during the year compared to 2006.

Although we have no exposure to the subprime mortgage market, the current economic environment has resulted in an increase in our delinquencies and classified assets over the past two years. Our ratio of net charge-offs to average loans was 0.24% for the year ended December 31, 2008 compared to 0.16% in 2007 and 0.11% in 2006, while the ratio of nonperforming assets to total assets was 1.29% at December 31, 2008 compared to 0.47% at December 31, 2007 and 0.39% at December 31, 2006.

Net internal loan growth was $133 million in 2008 compared to $154 million in 2007 and $252 million in 2006.

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

Noninterest Income

Our noninterest income amounted to $21,107,000 in 2008, $18,473,000 in 2007, and $14,310,000 in 2006.

As shown in Table 4, core noninterest income, which excludes gains and losses from sales of securities, loans, and other assets, amounted to $20,965,000 in 2008, a 16.5% increase from $17,996,000 in 2007. The 2007 core noninterest income of $17,996,000 was 11.1% higher than the $16,204,000 recorded in 2006.

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

36

Table of Contents

Service charges on deposit accounts in 2008 amounted to $13,535,000, a 35.5% increase compared to $9,988,000 recorded in 2007. The $9,988,000 recorded in 2007 was 11.4% more than the 2006 amount of $8,968,000. The primary reason for the increases in this category was the expansion of our overdraft protection program in the fourth quarter of 2007 to include overdraft protection for debit card purchases and ATM withdrawals. Previously the overdraft protection program, in which we charge a fee for honoring payments on overdrawn accounts, only applied to written checks.

Other service charges, commissions and fees amounted to $4,842,000 in 2008, a 6.1% decrease from the $5,158,000 earned in 2007. The 2007 amount of $5,158,000 was 12.7% higher than the $4,578,000 recorded in 2006. This category of noninterest income includes items such as electronic payment processing revenue (which includes fees related to credit card transactions by merchants and customers and fees earned from debit card transactions), ATM charges, safety deposit box rentals, fees from sales of personalized checks, and check cashing fees. The decline in this category of revenues was primarily related to a switch we made in credit card processors in late 2007. With our previous credit card processor, we received revenue from credit card processing and then we paid a large portion of this revenue back out as expense to the credit card company. With our new credit card processor, they pay the credit card company directly and only remit to us the net revenue. Thus, with the new processor, we record lower revenue and lower expense than we did with our prior processor (and approximately the same amount of net revenue). As a result of this change, merchant credit card income totaled $683,000 in 2008 compared to $1,635,000 in 2007, a decrease of $952,000. Excluding the impact of this change, “Other service charges, commissions and fees” would have increased $636,000 in 2008 after having increased by $580,000 in 2007. The growth in this category (as adjusted) is primarily due to the increased acceptance and popularity of debit cards (for which we earn income for each use by our customers) and the overall growth in our total customer base, including growth achieved from corporate acquisitions.

Fees from presold mortgages amounted to $869,000 in 2008, $1,135,000 in 2007, and $1,062,000 in 2006. The decrease in fees earned in 2008 was primarily a result of lower volume caused by the declining market for home sales.

Commissions from sales of insurance and financial products amounted to $1,552,000 in 2008, $1,511,000 in 2007, and $1,434,000 in 2006. This line item includes commissions we receive from three sources - 1) sales of credit life insurance associated with new loans, 2) commissions from the sales of investment, annuity, and long-term care insurance products, and 3) commissions from the sale of property and casualty insurance. The following table presents the contribution of each of the three sources to the total amount recognized in this line item:

($ in thousands)		2008	2007	2006
Commissions earned from:				
Sales of credit life insurance	$	294	304	337
Sales of investments, annuities, and long term care insurance		474	387	266
Sales of property and casualty insurance		784	820	831
Total	$	1,552	1,511	1,434

Data processing fees amounted to $167,000 in 2008, $204,000 in 2007, and $162,000 in 2006. As noted earlier, Montgomery Data makes its excess data processing capabilities available to area financial institutions for a fee. As of each of the years ended December 31, 2007 and 2006, Montgomery Data had two outside customers that were affiliated with each other. In 2008, the two customers merged with one another, thus leaving Montgomery Data with one customer at December 31, 2008. Montgomery Data intends to continue to market this service to area banks, but does not currently have any near-term prospects for additional business.

Table of Contents

Noninterest income not considered to be “core” amounted to a net gain of $142,000 in 2008, a net gain of $477,000 in 2007, and a net loss of $1,894,000 in 2006. In Table 4, the line item entitled “other gains (losses), net” totaling $156,000 in 2008 includes a gain of $306,000 related to the VISA initial public offering that occurred in March 2008. We were a member/owner of VISA and received a portion of VISA’s offering proceeds. “Other gains (losses), net” totaling $2,099,000 in 2006 includes a loss of $1,900,000 related to the write-off loss of a merchant credit card receivable. During 2006, we discovered that we had liability associated with a commercial merchant client that sold furniture over the internet. The furniture store did not deliver furniture that its customers had ordered and paid for, and was unable to immediately refund their credit card purchases. As the furniture store’s credit card processor, we became contractually liable for the amounts that were required to be refunded. During 2007, we determined that our ultimate exposure to this loss was approximately $190,000 less than the original estimated total loss of $1.9 million that had been expensed in 2006. Accordingly, we reversed $190,000 of this loss during 2007, which is included in “other gains (losses), net.”

As noted above, we terminated our contract with our previous credit card processor in 2007 and entered into a new contract with a different processor. The new contract shifts the risk of losses similar to the one described above from us to the third-party processor.

Also included in “other gains (losses), net” are normal and expected write-downs of tax credit partnership investments amounting to $344,000, $308,000 and $295,000 in 2008, 2007, and 2006, respectively. We project $320,000 in tax credit investment write-downs in 2009. Our total investment in tax credit partnerships amounted to $1.0 million, $1.4 million and $1.6 million at December 31, 2008, 2007, and 2006, respectively. To date, all tax credit write-downs have been exceeded, and are projected to continue to be exceeded, by the amount of tax credits realized and recorded as a reduction of income tax expense.

We realized a net securities loss of $14,000 in 2008 and net securities gains of $487,000 and $205,000 in 2007 and 2006, respectively. The sales in 2007 and 2006 were initiated primarily to realize current income.

Noninterest Expenses

Noninterest expenses for 2008 were $62,661,000, compared to $57,580,000 in 2007 and $53,198,000 in 2006. Table 5 presents the components of our noninterest expense during the past three years.

Based on the amounts noted above, noninterest expenses increased 8.8% in 2008 and 8.2% in 2007. The increases in noninterest expenses over the past three years have occurred in nearly every line item of expense and have been primarily a result of our significant growth. Over the past three years, our number of bank branches has increased from 61 to 74, and the number of full time equivalent employees has increased from 578 at December 31, 2005 to 650 at December 31, 2008. Additionally, from December 31, 2005 to December 31, 2008, the amount of loans outstanding increased 49.2% and deposits increased 38.8%.

Our ratio of noninterest expense to average assets was 2.52% in 2008 compared to 2.69% in 2007 and 2.77% in 2006. Our efficiency ratio (the sum of tax-equivalent net interest income plus noninterest income divided by noninterest expense) was 57.85% in 2008 compared to 58.57% in 2007 and 59.54% in 2006. For both of the ratios just noted, a lower ratio is more favorable than a higher ratio.

From 2004 through 2006, we were not required to pay any FDIC deposit insurance premiums. As discussed above in “Supervision and Regulation of the Bank,” in 2006 the FDIC modified its rules relating to the assessment of deposit insurance premiums. In 2007, we incurred approximately $100,000 in FDIC deposit insurance premium expense compared to none in 2006. In 2008, we recorded FDIC insurance expense of $1.2 million.

On December 16, 2008, the FDIC raised the deposit insurance assessment rates uniformly for all institutions by 7 cents for every $100 of domestic deposits effective for the first quarter of 2009. On February 27, 2009, the

Table of Contents

FDIC announced that, commencing in April 2009, its minimum rates would increase to a range of twelve cents to sixteen cents per $100 in deposits. Excluding the special assessment discussed below, we estimate that our annual FDIC insurance premium expense will be approximately $3.0 million in 2009, a $1.8 million increase from 2008, as a result of the rate changes.

The FDIC also announced on February 27, 2009 an interim rule that would impose a one-time special assessment of twenty cents per $100 in insured deposits to be collected on September 30, 2009. Unless there are changes to the final rule, we estimate that our one-time special assessment will total approximately $4 million. The interim rule would also permit the FDIC to impose emergency special assessments from time to time after June 30, 2009 if the FDIC board believes the reserve fund will fall to a level that would adversely affect public confidence in federal deposit insurance.

Additionally, based on preliminary actuarial reports, we expect our pension expense to increase from $2.3 million in 2008 to $3.6 million in 2009, an increase of $1.3 million, primarily as a result of investment losses experienced by the pension plan's assets in 2008.

Income Taxes

The provision for income taxes was $13,120,000 in 2008, $13,150,000 in 2007, and $11,423,000 in 2006.

Table 6 presents the components of tax expense and the related effective tax rates. The effective tax rate for 2008 was 37.4% compared to 37.6% in 2007 and 37.2% in 2006. We recorded nonrecurring adjustments in the third quarter of 2006 amounting to $182,000 that reduced otherwise reported income tax expense. We expect our effective tax rate to be in the 37%-38% range for the foreseeable future.

Table 1 reflects the fact that in 2005, we recorded incremental tax expense of $4.3 million related to the settlement of a state tax matter with the North Carolina Department of Revenue. See prior year filings for discussion of this matter.

Stock-Based Compensation

We recorded stock-based compensation expense of $143,000, $190,000 and $325,000 for the years ended December 31, 2008, 2007 and 2006, respectively.

During 2006 and 2007, the only stock-based grants made by the company were grants of 2,250 options to each of the Company's non-employee directors on June 1 of each year. In 2008, in addition to the annual director grant, our board of directors approved a grant of incentive-based stock awards to 19 senior officers under the First Bancorp 2007 Equity Plan ("2007 Equity Plan") as discussed in the following paragraph.

On June 17, 2008, 262,599 stock options and 81,337 performance units were awarded to 19 senior officers under the 2007 Equity Plan. Each performance unit represents the right to acquire one share of First Bancorp common stock upon satisfaction of the vesting conditions. This grant has both performance conditions (earnings per share targets) and service conditions that must be met in order to vest. The 262,599 stock options and 81,337 performance units represented the maximum amount of options and performance units that could have vested if the Company were to achieve specified maximum goals for earnings per share during the three annual performance periods ending on December 31, 2008, 2009, and 2010. Up to one-third of the total number of options and performance units granted will vest annually as of December 31 of each year beginning in 2010, if (1) the Company achieves specific EPS goals during the corresponding performance period and (2) the executive or key employee continues employment for a period of two years beyond the corresponding performance period. Compensation expense for this grant will be recorded over the various service periods based on the estimated number of options and performance units that are probable to vest. If the awards do not vest, no compensation cost will be recognized and any previously recognized compensation cost will be reversed. When the award grant was made, it was expected that compensation expense for each of the first three years would range from $0 to $700,000, depending on the number of awards that vested, with the expense being approximately $350,000 per

Table of Contents

year if the targeted levels of performance were met. Since the grant date, we have concluded that is not probable that any of these awards will vest because minimum performance levels will not be met, and therefore no compensation expense has been recorded. We did not achieve the minimum earnings per share performance goal for 2008, and thus one-third of the above grant has been permanently forfeited.

Under the assumption that the incentive grants noted above do not vest, our stock-based compensation expense related to options currently outstanding will be approximately $9,000 in each of 2009 and 2010, $6,000 in each of 2011 and 2012, and $1,000 in 2013. There is no tax benefit related to any of those expenses. Any new stock-based awards that are granted and vest after January 1, 2009 will increase the amount of stock-based compensation expense that we record. We expect to continue the annual grant of 2,250 stock options to each of our non-employee directors in 2009. This annual grant resulted in us recording an expense of $135,000 ($82,000 after-tax) in 2008.

ANALYSIS OF FINANCIAL CONDITION AND CHANGES IN FINANCIAL CONDITION

Overview

Over the past two years, we have achieved steady increases in our levels of loans and deposits, which has resulted in an increase in assets from $2.1 billion at December 31, 2006 to $2.8 billion at December 31, 2008. This growth has been both internally generated and acquired. During the second quarter of 2008, we completed the acquisition of Great Pee Dee Bancorp, Inc. We did not complete any acquisitions in 2007. The following table presents detailed information regarding the nature of our growth in 2007 and 2008:

(in thousands)	Balance at beginning of period	Internal growth	Growth from Acquisitions – Great Pee Dee	Balance at end of period	Total percentage growth	Internal growth (1)
2008						
Loans	$ 1,894,295	133,180	183,840	2,211,315	16.7%	7.0%
Deposits						
Noninterest bearing	232,141	(11,099)	8,436	229,478	-1.1%	-4.8%
NOW	192,785	(4,405)	10,395	198,775	3.1%	-2.3%
Money Market	264,653	61,025	15,061	340,739	28.7%	23.1%
Savings	100,955	21,697	2,588	125,240	24.1%	21.5%
Time>$100,000 – non-brokered	479,176	(3,225)	37,672	513,623	7.2%	-0.7%
Time>$100,000 – brokered	–	53,012	25,557	78,569	n/a	n/a
Time<$100,000	568,567	(28,200)	48,000	588,367	3.5%	-5.0%
Total deposits	$ 1,838,277	88,805	147,709	2,074,791	12.9%	4.8%
2007						
Loans	$ 1,740,396	153,899		1,894,295	8.8%	8.8%
Deposits						
Noninterest bearing	217,291	14,850		232,141	6.8%	6.8%
NOW	193,435	(650)		192,785	-0.3%	-0.3%
Money Market	205,994	58,659		264,653	28.5%	28.5%
Savings	103,346	(2,391)		100,955	-2.3%	-2.3%
Time>$100,000	422,772	56,404		479,176	13.3%	13.3%

Time<$100,000	552,841	15,726	568,567	2.8%	2.8%
Total deposits	$ 1,695,679	142,598	1,838,277	8.4%	8.4%

(1) Excludes the impact of acquisitions.

As shown in the table above, we experienced internal loan growth of 7.0% and 8.8%, in 2008 and 2007, respectively. The growth experienced in 2007 and 2008 was partially due to our 2005 expansion into

Table of Contents

Mooresville, North Carolina, a high growth market near Charlotte, and our 2005 expansion into the coastal North Carolina counties of New Hanover County and Brunswick County. Loan growth in these markets totaled $77 million in 2008 and $89 million in 2007.

Internal deposit growth was 4.8% in 2008 and 8.4% in 2007. Money market accounts had the highest growth in both years. The growth in money market accounts was almost entirely due to the introduction in late 2005 of a high interest rate money market account that was created in order to attract deposits to fund loan growth, as well as to enhance overall liquidity. We believe that the generally lower growth (or negative growth) experienced in both years in the other non-time deposit categories was partially a result of customers shifting funds to this money market account. The increase in the Savings category in 2008 was due to a $25 million deposit from one customer into a high interest rate savings account.

Internal non-brokered time deposit growth (both large and small denomination) increased in 2007 and decreased in 2008. Time deposits are a rate sensitive category of deposits. In 2007, we offered promotional interest rates in order to help fund strong loan growth. In 2008, we decided not to match promotional time deposit interest rates being offered by several of our local competitors, which we felt were too high compared to alternative funding sources, and consequently we experienced a loss of internally generated time deposits. Instead of matching the high interest rates, we decided to utilize brokered time deposits because they had interest rates meaningfully lower than rates in the local marketplace. We ended 2008 with a total of $79 million in brokered time deposits compared to none in 2007. The $79 million in brokered time deposits at December 31, 2008 represented just 3.8% of our total deposits, which we believe is a relatively low level of reliance on this wholesale funding source. In addition to the $79 million in brokered deposits at December 31, 2008, we also had $5 million in time deposits that we raised during the year from an internet posting service.

As can be seen in the table above, our acquisition of Great Pee Dee Bancorp on April 1, 2008 resulted in the assumption of $184 million in loans and $148 million in deposits.

Over the past few years, including 2007 and 2008, our loan growth has exceeded our deposit growth and to a greater extent exceeded our retail deposit growth (which excludes time deposits greater than $100,000). We believe the higher internal growth rates for loans compared to retail deposits over the past two years is largely attributable to the type of customers we have been able to attract. Most of our loan growth has come from small-business customers that need loans in order to expand their business, and have few deposits. Additionally, we have found it difficult to compete for retail deposits in recent years. We frequently compete against banks in the marketplace that either 1) are so large that they enjoy better economies of scale over us and can thus offer higher rates, or 2) are recently started banks that are focused on building market share, and not necessarily on positive earnings, by offering high deposit rates. We believe we enjoy advantages in the loan marketplace because of our seasoned lenders who have the experience necessary to oversee the completion of a loan and are afforded the autonomy to be able to make timely decisions.

Our liquidity decreased slightly in 2008 as a result of internal loan growth that exceeded internal deposit growth, as well as from our acquisition of Great Pee Dee. Great Pee Dee had a loan to deposit ratio of 124% on the date of acquisition. Our loan to deposit ratio was 106.6% at December 31, 2008 compared to 103.1% at December 31, 2007 and 102.6% at December 31, 2006.

Our capital ratios improved slightly in 2008 as a result of our all-stock acquisition of Great Pee Dee. All of our capital ratios have continually exceeded the regulatory thresholds for “well-capitalized” status for all periods covered by this report. On January 9, 2009, we sold $65 million of preferred stock to the US Treasury under the Capital Purchase Program. This sale of stock significantly enhanced our capital position.

Due to the recessionary economic environment that began in 2007, our asset quality ratios have worsened. Our nonperforming assets to total assets ratio was 1.29% at December 31, 2008 compared to 0.47% at December 31, 2007, and 0.39% at December 31, 2006. For the year ended December 31, 2008, our ratio of annualized net charge-offs to average loans was 0.24% compared to 0.16% for 2007, and 0.11% for 2006.

Distribution of Assets and Liabilities

Table 7 sets forth the percentage relationships of significant components of our balance sheet at December 31, 2008, 2007, and 2006.

For all three years, loans comprised 80%-81% of total assets. For both 2006 and 2007, deposits were 79% of total assets, while borrowings were 10%. In 2008, as a result of an increased reliance on borrowings to fund loan growth that has exceeded deposit growth, the percentage of deposits to total assets decreased to 76%, while the percentage of borrowings to total assets increased to 13%.

Securities

Information regarding our securities portfolio as of December 31, 2008, 2007, and 2006 is presented in Tables 8 and 9.

The composition of the investment securities portfolio reflects our investment strategy of maintaining an appropriate level of liquidity while providing a relatively stable source of income. The investment portfolio also provides a balance to interest rate risk and credit risk in other categories of the balance sheet while providing a vehicle for the investment of available funds, furnishing liquidity, and supplying securities to pledge as required collateral for certain deposits.

Total securities amounted to $187.2 million, $151.8 million, and $143.1 million at December 31, 2008, 2007, and 2006, respectively. The increase in securities over the past year was due to the acquisition of approximately $15 million in securities related to our acquisition of Great Pee Dee in 2008, as well as purchases of securities we needed in order to collateralize public deposits. Over the past year, we have primarily elected to purchase securities issued by the Federal Home Loan Bank, a government-sponsored enterprise, which, due to their non-amortizing nature, are easier to pledge than mortgage-backed securities and can be more easily purchased in shorter maturity terms than mortgage-backed securities. In general, we prefer to invest in short-term investments in order to provide liquidity and manage interest rate risk. We have never held investments in Freddie Mac or Fannie Mae preferred stock.

The majority of our "government-sponsored enterprise" securities are issued by the Federal Home Loan Bank and carry one maturity date, often with an issuer call feature. At December 31, 2008, of the $90 million in carrying value of government-sponsored enterprise securities, $75 million were issued by the Federal Home Loan Bank system and the other $15 million were issued by the Federal Farm Credit Bank system.

Our $47 million of mortgage-backed securities have been all been issued by either Freddie Mac, Fannie Mae, or Ginnie Mae, each of which are government-sponsored corporations. We have no "private label" mortgage-backed securities. Mortgage-backed securities vary in their repayment in correlation with the underlying pools of home mortgage loans.

Included in mortgage-backed securities at December 31, 2008 were collateralized mortgage obligations ("CMOs") with an amortized cost of $7.9 million and a fair value of $7.8 million. Included in mortgage-backed securities at December 31, 2007 were CMOs with an amortized cost of $9.6 million and a fair value of $9.4 million. Included in mortgage-backed securities at December 31, 2006 were CMOs with an amortized cost of $11.9 million and a fair value of $11.5 million. The CMOs that we have invested in are substantially all "early tranche" portions of the CMOs, which minimizes our long-term interest rate risk.

At December 31, 2008, our $17 million investment in corporate bonds was comprised of the following:

Table of Contents

Issuer ($ in thousands)	S&P Issuer Ratings (1)	Maturity Date	Amortized Cost	Market Value
First Citizens Bancorp (North Carolina) Bond	BB	4/1/15	$ 2,993	3,073
Citigroup Bond	(2)	2/15/16	3,100	2,847
Bank of America Trust Preferred Security	BB-	12/11/26	2,060	1,729
Wells Fargo Trust Preferred Security	A	1/15/27	2,576	2,008
Bank of America Trust Preferred Security	BB-	4/14/27	2,065	1,714
Bank of America Trust Preferred Security	BB-	4/15/27	3,007	2,572
First Citizens Bancorp (North Carolina) Trust Preferred Security	BB	3/1/28	2,084	2,385
First Citizens Bancorp (South Carolina) Trust Preferred Security	Not Rated	6/15/34	1,000	520
Total investment in corporate bonds			$ 18,885	16,848

(1) The ratings are as of March 11, 2009.

(2) This bond was called by Citigroup at par in February 2009 with no loss to First Bancorp.

Our $17 million investment in equity securities at each year end is comprised almost entirely of capital stock in the Federal Home Loan Bank of Atlanta. The Federal Home Loan Bank of Atlanta requires us to purchase their stock in order to borrow from them. The amount they require us to invest is based on our level of borrowings from them. At December 31, 2008, our investment in capital stock of the Federal Home Loan Bank of Atlanta amounted to $16.5 million of our total investment in equity securities of $17.0 million. Until February 27, 2009, the Federal Home Loan Bank of Atlanta redeemed their stock at par as borrowings were repaid. On February 27, 2009, the Federal Home Loan Bank of Atlanta announced that they would no longer automatically redeem their stock when loans are repaid. Instead, they stated that they would evaluate whether they would repurchase stock on a quarterly basis.

The fair value of securities held to maturity, which we carry at amortized cost, was $179,000 less than the carrying value at December 31, 2008 and $9,000 more than the carrying value at December 31, 2007. Our $16.0 million in securities held to maturity are comprised almost entirely of municipal bonds issued by state and local governments throughout our market area. The denominations of the bonds are all less than $600,000 and we have no significant concentration of bond holdings from one government entity, with the single largest exposure to any one entity being $812,000. Management evaluated any unrealized losses on individual securities at each year end and determined them to be of a temporary nature and caused by fluctuations in market interest rates, not by concerns about the ability of the issuers to meet their obligations.

At December 31, 2008, a net unrealized gain of $273,000 was included in the carrying value of securities classified as available for sale, compared to a net unrealized gain of $86,000 at December 31, 2007 and a net unrealized loss of $860,000 at December 31, 2006. In 2006, a steadily rising interest rate environment caused a decline in fair market value of securities. In 2007 and 2008, declines in interest rates resulted in unrealized gains at December 31, 2007 and 2008. Higher interest rates negatively impact the value of fixed income securities and conversely, lower interest rates have a positive impact on the value of fixed income securities. Management evaluated any unrealized losses on individual securities at each year end and determined them to be of a temporary nature and caused by fluctuations in market interest rates and the overall economic environment, not by concerns about the ability of the issuers to meet their obligations. Net unrealized gains (losses), net of applicable deferred income taxes, of $167,000, $52,000, and ($524,000) have been reported as part of a separate component of shareholders' equity (accumulated other comprehensive income (loss)) as of December 31, 2008, 2007, and 2006, respectively.

The weighted average taxable-equivalent yield for the securities available for sale portfolio was 4.26% at December 31, 2008. The expected weighted average life of the available for sale portfolio using the call date for above-market callable bonds, the maturity date for all other non-mortgage-backed securities, and the expected life for mortgage-backed securities, was 4.0 years.

The weighted average taxable-equivalent yield for the securities held to maturity portfolio was 6.38% at December 31, 2008. The expected weighted average life of the held to maturity portfolio using the call date for

Table of Contents

above-market callable bonds and the maturity date for all other securities, was 6.4 years.

As of December 31, 2008 and 2007, we own no investment securities of any one issuer, other than government-sponsored enterprises or corporations, in which aggregate book values and market values exceeded 10% of shareholders' equity.

Loans

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

The loan portfolio is the largest category of our earning assets and is comprised of commercial loans, real estate mortgage loans, real estate construction loans, and consumer loans. We restrict virtually all of our lending to our 28 county market area, which is located in central and southeastern North Carolina, three counties in southern Virginia and three counties in northeastern South Carolina. The diversity of the region's economic base has historically provided a stable lending environment.

In 2008, loans outstanding increased $317.0 million, or 16.7% to $2.21 billion. In 2007, loans outstanding increased $153.9 million, or 8.8%. Of the $317.0 million in loan growth in 2008, approximately $183.8 million was assumed in the acquisition of Great Pee Dee Bancorp, Inc. in April 2008. All of the loan growth in 2007 was internally generated, as we did not complete any acquisitions during that year. The majority of the 2008 and 2007 loan growth occurred in loans secured by real estate, with approximately $291.2 million, or 92.1% in 2008, and $136.7 million, or 88.9%, in 2007, of the net loan growth occurring in loans secured by real estate.

Table 10 indicates that the category of loans with the most variance in its amount outstanding as a percent of total loans over the past three years has been real estate – construction, land development & other land loans. This category comprised 16% of total loans at December 31, 2006, 21% at December 31, 2007 and 19% at December 31, 2008. The increase in 2007 was primarily attributable to the nature of the loan growth that we experienced when we expanded our branch network to the fast-growing southeast coast of North Carolina. In 2008, due to recessionary conditions, particularly in the housing market, loan demand for these types of loans weakened, and we tightened our loan underwriting criteria for these types of loans, which reduced growth.

Over the years, our loan mix has remained fairly consistent, with real estate loans (mortgage and construction) comprising approximately 86-87% of the loan portfolio, commercial, financial, and agricultural loans not secured by real estate comprising 9-10%, and consumer installment loans comprising 4-5% of the portfolio. The majority of our "real estate" loans are personal and commercial loans where real estate provides additional security for the loan.

At December 31, 2008, $1.929 billion, or 87%, of our loan portfolio was secured by liens on real property. Included in this total are $885 million, or 40% of total loans, in loans secured by liens on 1-4 family residential properties and $1.044 billion, or 47% of total loans, in loans secured by liens on other types of real estate. At December 31, 2007, $1.637 billion, or 86%, of our loan portfolio was secured by liens on real property. Included in this total are $724 million, or 38% of total loans, in loans secured by liens on 1-4 family residential properties and $913 million, or 48% of total loans, in loans secured by liens on other types of real estate. Our $1.929 billion in real estate mortgage loans at December 31, 2008 can be further classified as follows – for comparison purposes, the classification of our $1.637 billion real estate loan portfolio at December 31, 2007 is shown in parentheses:

- $628 million, or 28% of total loans (vs. $514 million, or 27% of total loans), are secured by first liens on residential homes, in which the borrower's personal income is generally the primary repayment source.
- $584 million, or 26% of total loans (vs. $496 million, or 26% of total loans), are primarily dependent on cash flow from a commercial business for repayment.

Table of Contents

- $214 million, or 10% of total loans (vs. $213 million, or 11% of total loans), are real estate construction loans.
- $257 million, or 12% of total loans (vs. $210 million, or 11% of total loans), are home equity loans (lines-of-credit and term loans) obtained by consumers for various purposes.
- $210 million, or 9% of total loans (vs. $171 million, or 9% of total loans), are tracts of unimproved land for investment or future development.
- $36 million, or 2% of total loans (vs. $33 million, or 2% of total loans), are primarily dependent on cash flow from agricultural crop sales.

Table 11 provides a summary of scheduled loan maturities over certain time periods, with fixed rate loans and adjustable rate loans shown separately. Approximately 30% of our loans outstanding at December 31, 2008 mature within one year and 79% of total loans mature within five years. As of December 31, 2008, the percentages of variable rate loans and fixed rate loans as compared to total performing loans were 45% and 55%, respectively. We intentionally make a blend of fixed and variable rate loans so as to reduce interest rate risk. See discussion regarding fluctuations in our ratio of fixed rate loans to variable rate loans in the section above entitled "Net Interest Income."

Nonperforming Assets

Nonperforming assets include nonaccrual loans, troubled debt restructurings, loans past due 90 or more days and still accruing interest, and other real estate. As a matter of policy we place all loans that are past due 90 or more days on nonaccrual basis, and thus there were no loans at any of the past five year ends that were 90 days past due and still accruing interest. Table 12 summarizes our nonperforming assets at the dates indicated.

Nonaccrual loans are loans on which interest income is no longer being recognized or accrued because management has determined that the collection of interest is doubtful. Placing loans on nonaccrual status negatively impacts earnings because (i) interest accrued but unpaid as of the date a loan is placed on nonaccrual status is reversed and deducted from interest income, (ii) future accruals of interest income are not recognized until it becomes probable that both principal and interest will be paid and (iii) principal charged-off, if appropriate, may necessitate additional provisions for loan losses that are charged against earnings. In some cases, where borrowers are experiencing financial difficulties, loans may be restructured to provide terms significantly different from the originally contracted terms.

Due largely to the recessionary economic conditions that began in late 2007 and worsened in 2008, we have experienced increases in our nonperforming assets.

Nonperforming loans as of December 31, 2008, 2007, and 2006 totaled $30,595,000, $7,813,000, and $6,862,000, respectively. Nonperforming loans as a percentage of total loans amounted to 1.38%, 0.41%, and 0.39%, at December 31, 2008, 2007, and 2006, respectively. Our largest nonaccrual relationships at December 31, 2008 and 2007 amounted to $1,600,000 and $530,000, respectively. At December 31, 2008, troubled debt restructurings amounted to $3,995,000, which was comprised of one land development loan for which we have reduced the interest rate from the original note rate of 7.75% to 5.00% because of financial difficulties being experienced by the borrower.

Table of Contents

The following is the composition by loan type of our nonaccrual loans at each period end:

	At December 31, 2008	At December 31, 2007
Commercial, financial, and agricultural	$ 1,726	504
Real estate – construction, land development, and other land loans	6,936	2,219
Real estate – mortgage – residential (1-4 family) first mortgages	10,856	1,515
Real estate – mortgage – home equity loans/lines of credit	2,242	1,130
Real estate – mortgage – commercial and other	3,624	1,370
Installment loans to individuals	1,216	1,069
Total nonaccrual loans	$ 26,600	7,807

Included in the table above are $3.1 million in loans that were acquired in the acquisition of Great Pee Dee and were written down on the acquisition date by $4.6 million from a total loan balance of $7.7 million.

If the nonaccrual and restructured loans as of December 31, 2008, 2007 and 2006 had been current in accordance with their original terms and had been outstanding throughout the period (or since origination if held for part of the period), gross interest income in the amounts of approximately $1,930,000, $610,000 and $510,000 for nonaccrual loans and $310,000, $1,000 and $1,000 for restructured loans would have been recorded for 2008, 2007, and 2006, respectively. Interest income on such loans that was actually collected and included in net income in 2008, 2007 and 2006 amounted to approximately $826,000, $252,000 and $179,000 for nonaccrual loans (prior to their being placed on nonaccrual status), and $155,000, $1,000, and $1,000 for restructured loans, respectively. At December 31, 2008 and 2007, the Company had no commitments to lend additional funds to debtors whose loans were nonperforming.

Management routinely monitors the status of certain large loans that, in management's opinion, have credit weaknesses that could cause them to become nonperforming loans. In addition to the nonperforming loan amounts discussed above, management believes that an estimated $15-$17 million of loans that were performing in accordance with their contractual terms at December 31, 2008 have the potential to develop problems depending upon the particular financial situations of the borrowers and economic conditions in general. Management has taken these potential problem loans into consideration when evaluating the adequacy of the allowance for loan losses at December 31, 2008 (see discussion below).

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

Other real estate includes foreclosed, repossessed, and idled properties. Other real estate has increased over the past three years, amounting to $4,832,000 at December 31, 2008, $3,042,000 at December 31, 2007, and $1,539,000 at December 31, 2006. Other real estate represented approximately 0.07%-0.18% of total assets at each of the past three year ends. The increases in other real estate are due to increased foreclosure activity as a result of the recessionary economic conditions. At December 31, 2008, the largest balance related to any single piece of other real estate was $425,000. Our management believes that the fair values of the items of other real estate, less estimated costs to sell, equal or exceed their respective carrying values at the dates presented.

Table of Contents

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

	At December 31, 2008	At December 31, 2007
Vacant land	$ 975	344
1-4 family residential properties	2,149	2,073
Commercial real estate	1,693	592
Other	15	33
Total other real estate	$ 4,832	3,042

Allowance for Loan Losses and Loan Loss Experience

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

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

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

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

The allowance for loan losses amounted to $29,256,000 at December 31, 2008 compared to $21,324,000 at December 31, 2007 and $18,947,000 at December 31, 2006. This represented 1.32%, 1.13%, and 1.09%, of loans outstanding as of December 31, 2008, 2007, and 2006, respectively. The higher percentages in 2007 and 2008 are primarily associated with higher levels of classified assets. As noted in Table 12, our allowance for loan losses as a percentage of nonperforming loans ("coverage ratio") amounted to 96% at December 31, 2008 compared to 273% at December 31, 2007 and 276% at December 31, 2006. Due to the secured nature of virtually all of our loans that are on nonaccrual status, the variance in the coverage ratio is not necessarily indicative of the relative adequacy of the allowance for loan losses. Additionally, there are $3.1 million in nonaccrual loans acquired in the acquisition of Great Pee Dee that were written down on the acquisition date by $4.6 million from a total loan balance of $7.7 million.

Table 13 sets forth the allocation of the allowance for loan losses at the dates indicated. The amount of the unallocated portion of the allowance for loan losses did not vary materially at any of the past three year ends.

Table of Contents

The allowance for loan losses is available to absorb losses in all categories.

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

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

For the years indicated, Table 14 summarizes our balances of loans outstanding, average loans outstanding, and a detailed rollforward of the allowance for loan losses. In addition to the increases to the allowance for loan losses related to normal provisions, the increases in the dollar amounts of the allowance for loan losses in 2008 and 2006 were also affected by amounts recorded to provide for loans assumed in corporate acquisitions. In 2008, we added $3,158,000 to the allowance for loan losses related to approximately $184 million in loans assumed in the acquisition of Great Pee Dee in April 2008. In 2006, we added $52,000 to the allowance for loan losses related to approximately $6 million in loans assumed in a branch acquisition.

Table 14 also provides a breakout of loans charged-off and recoveries of loans previously charged-off based on the loan type. In years prior to 2006, our policy was to record net charge-offs related to deposit overdrafts as a reduction to service charges on deposits accounts. Based on regulatory requirements, on July 1, 2006, we began recording charge-offs and recoveries related to deposit overdrafts to the allowance for loan losses. Total net charge-offs related to overdrafts that were recorded as a reduction to service charges on deposit accounts instead of a reduction to the allowance for loan losses amounted to $81,000 for the six months ended June 30, 2006 and $248,000 and $258,000 for the years ended December 31, 2005, and 2004, respectively.

Net loan charge-offs amounted to $5,106,000 in 2008, $2,840,000 in 2007, and $1,744,000 in 2006. The higher amounts in 2008 reflect the impact of deteriorating loan quality that has been impacted by the recessionary economic conditions. This represents 0.24%, 0.16%, and 0.11% of average loans during 2008, 2007, and 2006 respectively. In each of the past five years, our net charge-off ratio has been in the range of 0.11%-0.24%.

Deposits and Securities Sold Under Agreements to Repurchase

At December 31, 2008, deposits outstanding amounted to $2.075 billion, an increase of $237 million, or 12.9%, from December 31, 2007. Approximately $89 million, or 38%, of the deposit growth in 2008 was internally generated, while the remaining $148 million, or 62%, resulted from the acquisition of Great Pee Dee in April 2008. In 2007, deposits grew from $1.696 billion to $1.838 billion, an increase of $142 million, or 8.4%, from December 31, 2006. There were no deposits assumed in acquisitions in 2007.

Table of Contents

The nature of our deposit growth is illustrated in the table on page 40. The following table reflects the mix of our deposits at each of the past three year ends:

	2008	2007	2006
Noninterest-bearing deposits	11%	13%	13%
NOW deposits	10%	10%	11%
Money market deposits	16%	14%	12%
Savings deposits	6%	6%	6%
Time deposits > $100,000 – non-brokered	25%	26%	25%
Time deposits > $100,000 – brokered	4%	–	–
Time deposits < $100,000	28%	31%	33%
Total deposits	100%	100%	100%
Securities sold under agreements to repurchase as a percent of total deposits	3%	2%	3%

The deposit mix remained relatively consistent from 2006 to 2008, with the largest variances being an increase in money market deposits and brokered time deposits, and a decrease in time deposits less than $100,000. The growth in money market accounts was almost entirely due to the introduction in late 2005 of a high interest rate money market account that was created in order to attract deposits to fund loan growth, as well as to enhance overall liquidity. The decline in time deposits less than $100,000 has been primarily due to our decision not to match promotional time deposit interest rates being offered by several of our local competitors, which we felt were too high compared to alternative funding sources, and consequently we experienced a loss of some time deposits. Instead of matching the high interest rates, we decided to utilize brokered time deposits because they had interest rates meaningfully lower than rates in the local marketplace. We ended 2008 with a total of $79 million in brokered time deposits compared to none in 2007. The $79 million in brokered time deposits at December 31, 2008 represented 3.8% of our total deposits, which we believe is a relatively low level of reliance on this wholesale funding source. In addition to the $79 million in brokered deposits at December 31, 2008, we also had $5 million in time deposits that we raised during the year from an internet posting service.

Of the $79 million in brokered time deposits outstanding at year end, $9 million were deposits that we received from customers that we placed into the Certificate of Deposit Account Registry Service (CDARS). CDARS is a third-party network that allows customers to obtain FDIC insurance on deposits of up to $50 million, while dealing with just one bank. We introduced this product to our customers in 2008. Now, when a customer deposits a large amount with the Bank, the customer has the option of accessing the CDARS network, whereby we place the funds into certificates of deposit issued by other banks in the same network in increments less than $100,000 each so that both the principal and interest is eligible for complete FDIC protection. As a result, our customers can receive FDIC coverage from many banks, while still working with their local First Bank branch.

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

Table 15 presents the average amounts of our deposits and the average yield paid for those deposits for the years ended December 31, 2008, 2007, and 2006.

As of December 31, 2008, we held approximately $592.2 million in time deposits of $100,000 or more. Table 16 is a maturity schedule of time deposits of $100,000 or more as of December 31, 2008. This table shows that 90% of our time deposits greater than $100,000 mature within one year.

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

Table of Contents

Borrowings

We had borrowings outstanding of $367.3 million at December 31, 2008 compared to $242.4 million at December 31, 2007. As shown in Table 2, average borrowings have increased over the past three years, amounting to $113 million in 2006, increasing by $17 million to $130 million in 2007, and increasing by $97 million to $227 million in 2008. The increase in borrowings in 2008 and 2007 has been primarily a result of needing to fund loan growth that has exceeded deposit growth, as well as $41 million in borrowings assumed in the acquisition of Great Pee Dee. In 2008, average loans outstanding were $309 million higher than in 2007, whereas average deposits increased by only $205 million. In 2007, average loans increased by $185 million compared to average deposit growth of $181 million.

At December 31, 2008, the Company had three sources of readily available borrowing capacity – 1) an approximately $549 million line of credit with the FHLB, of which $265 million was outstanding at December 31, 2008 and $176 million was outstanding at December 31, 2007, 2) a $50 million overnight federal funds line of credit with a correspondent bank, of which $35 million was outstanding at December 31, 2008 and none was outstanding at December 31, 2007, and 3) an approximately $122 million line of credit through the Federal Reserve Bank of Richmond's (FRB) discount window, none of which was outstanding at December 31, 2008 or 2007.

Our line of credit with the FHLB can be structured as either short-term or long-term borrowings, depending on the particular funding or liquidity need, and is secured by our FHLB stock and a blanket lien on most of our real estate loan portfolio. As of December 31, 2008, $230 million of the $265 million outstanding with the FHLB were overnight borrowings (daily renewable) with a weighted-average interest rate of 0.46%, with the remaining $35 million outstanding having a weighted average interest rate of 4.38% and maturity dates ranging from April 2009 to April 2012. For the year ended December 31, 2008, the average amount of FHLB borrowings outstanding was approximately $158 million and had a weighted average interest rate for the year of 2.49%. The maximum amount of short-term FHLB borrowings outstanding at any month-end during 2008 was $265 million.

In addition to the outstanding borrowings from the FHLB that reduce the available borrowing capacity of the line of credit, the borrowing capacity was further reduced by $75 million and $40 million at December 31, 2008 and 2007, respectively, as a result of the pledging letters of credit backed by the FHLB for public deposits at each of those dates.

Our correspondent bank relationship allows us to purchase up to $50 million in federal funds on an overnight, unsecured basis (federal funds purchased). We had $35 million borrowings outstanding under this line at December 31, 2008. We had no borrowings outstanding under this line at December 31, 2007. This line of credit was not drawn upon during any of 2007 or 2006.

We also have a line of credit with the FRB discount window. This line is secured by a blanket lien on a portion of our commercial and consumer loan portfolio (excluding real estate loans). Based on the collateral that we owned as of December 31, 2008, the available line of credit was approximately $122 million. This line of credit was established primarily in connection with our Y2K liquidity contingency plan and has not been drawn on since inception.

In addition to the lines of credit described above, in which we had $300 million and $176 million outstanding as of December 31, 2008, and 2007, respectively, we also had a total of $46.4 million in trust preferred security debt outstanding at December 31, 2008 and 2007. We have initiated three trust preferred security issuances since 2002 totaling $67.0 million, with one of those issuances for $20.6 million being redeemed in 2007. These borrowings each have 30 year final maturities and were structured in a manner that allows them to qualify as capital for regulatory capital adequacy requirements. We may call these debt securities at par on any quarterly interest payment date five years after their issue date. We issued $20.6 million of this debt on October 29, 2002

(which we called in 2007 – see discussion below), an additional $20.6 million on December 19, 2003, and $25.8 million on April 13, 2006. The interest rate on these debt securities adjusts on a quarterly basis at a rate of three-month LIBOR plus 2.70% for the securities issued in 2003, and three-month LIBOR plus 1.39% for the securities issued in 2006.

In November 2007, we called and redeemed at par the $20.6 million in trust preferred securities that were issued in 2002 at a rate of LIBOR plus 3.45%. Our original intent was to replace the called securities with a new issuance at a lower interest rate that would also qualify as regulatory capital. However, our ability to issue new trust preferred securities into the marketplace was negatively impacted by the liquidity and credit concerns experienced in the United States economy beginning in the fall of 2007. We observed that very few trust preferred securities were being issued in the marketplace in the fall of 2007, and those that were issued carried a significantly higher interest rate than those issued in recent years. It was our general belief that this period of low demand and high interest rates in the marketplace was a temporary phenomenon and that the opportunity to issue new trust preferred securities at more favorable rates would return in the near future. Accordingly, we elected to fund the redemption of the trust preferred securities issued in 2002 with a $20 million line of credit that we obtained from a third-party commercial bank. This line of credit has a maturity date of October 30, 2009 and carries an interest rate of either i) prime minus 1.00% or ii) LIBOR plus 1.50%, at our discretion. Although this line of credit does not qualify as regulatory capital, our capital ratios continued to exceed the regulatory thresholds for "well-capitalized" status following the redemption. As discussed in "Capital Resources and Shareholders' Equity" below, due to the unfavorable capital markets, we have been unable to issue new trust preferred securities.

We incurred approximately $1,195,000 in debt issuance costs related to the 2002 and 2003 trust preferred security issuances that were recorded as prepaid expenses that are being amortized to the earliest call dates and are included in the "Other Assets" line item of the consolidated balance sheet. No debt issuance costs were incurred with the 2006 issuance.

Liquidity, Commitments, and Contingencies

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

As noted above, in addition to internally generated liquidity sources, we have the ability to obtain borrowings from the following three sources – 1) an approximately $549 million line of credit with the FHLB, 2) a $50 million overnight federal funds line of credit with a correspondent bank, and 3) an approximately $122 million line of credit through the FRB's discount window.

Our liquidity decreased slightly in 2008 as a result of internal loan growth that exceeded internal deposit growth, as well as from our acquisition of Great Pee Dee. Great Pee Dee had a loan to deposit ratio of 124% on the date of acquisition. Our loan to deposit ratio was 106.6% at December 31, 2008 compared to 103.1% at December 31, 2007 and 102.6% at December 31, 2006. The negative impact on our liquidity due to the imbalance in loan and deposit growth has been offset by increased borrowings.

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.

In the normal course of business we have various outstanding contractual obligations that will require future

51

cash outflows. In addition, there are commitments and contingent liabilities, such as commitments to extend credit, that may or may not require future cash outflows.

Table 18 reflects our contractual obligations and other commercial commitments outstanding as of December 31, 2008. Any of our $265 million in outstanding borrowings with the FHLB may be accelerated immediately by the FHLB in certain circumstances, including material adverse changes in our condition or if our qualifying collateral is less than the amount required under the terms of the borrowing agreement.

In the normal course of business there are various outstanding commitments and contingent liabilities such as commitments to extend credit, which are not reflected in the financial statements. As of December 31, 2008, we have outstanding unfunded loan and credit card commitments of $341,515,000, of which $291,784,000 were at variable rates and $49,731,000 were at fixed rates. Included in outstanding loan commitments were unfunded commitments of $212,430,000 on revolving credit plans, of which $185,985,000 were at variable rates and $26,445,000 were at fixed rates.

At December 31, 2008 and 2007, we had $8,297,000 and $6,176,000, respectively, in standby letters of credit outstanding. We had no carrying amount for these standby letters of credit at either of those dates. The nature of the standby letters of credit is that of a guarantee made on behalf of our customers to suppliers of the customers to guarantee payments owed to the supplier by the customer. The standby letters of credit are generally for terms of one year, at which time they may be renewed for another year if both parties agree. The payment of the guarantees would generally be triggered by a continued nonpayment of an obligation owed by the customer to the supplier. The maximum potential amount of future payments (undiscounted) we could be required to make under the guarantees in the event of nonperformance by the parties to whom credit or financial guarantees have been extended is represented by the contractual amount of the financial instruments discussed above. In the event that we are required to honor a standby letter of credit, a note, already executed by the customer, becomes effective providing repayment terms and any collateral. Over the past ten years, we have had to honor one standby letter of credit, which was repaid by the borrower without any loss to us. We expect any draws under existing commitments to be funded through normal operations.

It has been our experience that deposit withdrawals are generally replaced with new deposits, thus not requiring any net cash outflow. Based on that assumption, management believes that it can meet its contractual cash obligations and existing commitments from normal operations.

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

Capital Resources and Shareholders’ Equity

Shareholders’ equity at December 31, 2008 amounted to $219.9 million compared to $174.1 million at December 31, 2007. The two basic components that typically have the largest impact on our shareholders’ equity are net income, which increases shareholders’ equity, and dividends declared, which decreases shareholders’ equity. Additionally, any stock issued in acquisitions can significantly impact shareholders’ equity.

In 2008, net income of $22.0 million increased equity, while dividends declared of $12.2 million reduced equity. We also issued $37.6 million in common stock in our acquisition of Great Pee Dee. Other less significant items affecting shareholders’ equity in 2008 were 1) proceeds of $0.7 million received from common stock issued as a result of stock option exercises, 2) proceeds of $1.3 million received from the issuance of stock into our dividend reinvestment plan, and 3) other comprehensive loss of $3.8 million , which was primarily comprised of a $3.9 million negative adjustment to equity related to the funded status of our two defined benefit plans in accordance with Statement of

Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" (Statement 158). This negative adjustment was caused primarily by significant investment losses that our pension plan experienced in the stock market. See Notes 1(s)

52

and 11 to our consolidated financial statements for additional discussion of Statement 158.

In 2007, net income of $21.8 million increased equity, while dividends declared of $10.9 million reduced equity. Other less significant items affecting shareholders' equity in 2007 were 1) proceeds of $0.6 million received from common stock issued as a result of stock option exercises, 2) repurchases of 27,000 shares of the Company's common stock at an average price of $19.41, which reduced shareholders' equity by $0.5 million, and 3) other comprehensive gain of $0.2 million, which was primarily comprised of a $0.6 million increase in the net unrealized gain, net of taxes, of our available for sale securities and a $0.4 million negative adjustment to equity related to the funded status of our two defined benefit plans.

In 2006, net income of $19.3 million increased equity, while dividends declared of $10.6 million reduced equity. Other less significant items affecting shareholders' equity in 2006 were 1) proceeds of $1.0 million received from common stock issued as a result of stock option exercises, 2) proceeds of $1.6 million received from the issuance of stock into our dividend reinvestment plan, 3) repurchases of 53,000 shares of the Company's common stock at an average price of $20.97, which reduced shareholders' equity by $1.1 million, and 4) a $3.8 million negative adjustment to equity related to the initial adoption of Statement 158.

Except for recently implemented increases in FDIC premiums and a proposed one-time special assessment (see previous discussion in the section "Noninterest Expenses"), we are not aware of any recommendations of regulatory authorities or otherwise which, if they were to be implemented, would have a material effect on our liquidity, capital resources, or operations.

The Company and the Bank must comply with regulatory capital requirements established by the FRB and the FDIC. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. These capital standards require the Company and the Bank to maintain minimum ratios of "Tier 1" capital to total risk-weighted assets ("Tier I Capital Ratio") and total capital to risk-weighted assets ("Total Capital Ratio") of 4.00% and 8.00%, respectively. Tier 1 capital is comprised of total shareholders' equity, excluding unrealized gains or losses from the securities available for sale, less intangible assets, and total capital is comprised of Tier 1 capital plus certain adjustments, the largest of which for the Company and the Bank is the allowance for loan losses. Risk-weighted assets refer to the on- and off-balance sheet exposures of the Company and the Bank, adjusted for their related risk levels using formulas set forth in FRB and FDIC regulations.

In addition to the risk-based capital requirements described above, the Company and the Bank are subject to a leverage capital requirement, which calls for a minimum ratio of Tier 1 capital (as defined above) to quarterly average total assets ("Leverage Ratio) of 3.00% to 5.00%, depending upon the institution's composite ratings as determined by its regulators. The FRB has not advised the Company of any requirement specifically applicable to it.

Table 21 presents our regulatory capital ratios as of December 31, 2008, 2007, and 2006. All of our capital ratios have significantly exceeded the minimum regulatory thresholds for all periods covered by this report.

In addition to the minimum capital requirements described above, the regulatory framework for prompt corrective action also contains specific capital guidelines for a bank's classification as "well capitalized." The specific guidelines are as follows – Tier I Capital Ratio of at least 6.00%, Total Capital Ratio of at least 10.00%, and a Leverage Ratio of at least 5.00%. If a bank falls below "well capitalized" status in any of these three ratios, it must ask for FDIC permission to originate or renew brokered deposits. The Bank's regulatory ratios exceeded the threshold for "well-capitalized" status at December 31, 2008, 2007, and 2006 – see Note 15 to the consolidated financial statements for a table that presents the Bank's regulatory ratios.

In addition to shareholders' equity, we have supplemented our capital in recent years with trust preferred

Table of Contents

security debt issuances, which because of their structure qualify as regulatory capital. This has generally been necessary because our balance sheet growth has outpaced the growth rate of our capital. Additionally, we have purchased several bank branches over the years that resulted in us recording intangible assets, which negatively impacted regulatory capital ratios. As discussed in "Borrowings" above, we have issued a total of $67.0 million in trust preferred securities since 2002, with the most recent issuance being a $25.8 million issuance that occurred in April 2006. Also as discussed above, in November 2007 we elected to redeem $20.6 million of these trust preferred securities due to their high interest rate. Due to unfavorable market conditions, we elected to fund the redemption not with new trust preferred securities, which was our original intent, but rather with a third-party line of credit, which does not quality as regulatory capital. This redemption reduced our regulatory capital by $20 million and reduced each of our regulatory capital ratios by approximately 100 basis points. Our intent was to replace this capital with a new trust preferred security issuance when the capital markets stabilized, but to date the trust preferred security capital market remains effectively closed.

Our goal is to maintain our capital ratios at levels no less than the "well-capitalized" thresholds set for banks. At December 31, 2008, our total risk-based capital ratio was 10.65% compared to the 10.00% "well-capitalized" threshold.

In light of the current economic conditions and the state of the capital markets, we elected to strengthen our capital ratios by participating in the U.S. Treasury Capital Purchase Program, which was announced in October 2008. On January 9, 2009, we completed the sale of $65 million of preferred stock to the U.S. Treasury Department. See "U.S. Treasury Capital Purchase Program" above and Note 18 to the consolidated financial statements for additional discussion. The addition of $65 million in Tier 1 capital on January 9, 2009 increased our capital ratios. If the transaction had occurred on December 31, 2008, our capital ratios would have been as follows:

	As Reported December 31, 2008	Pro Forma December 31, 2008
Risk-based capital ratios:		
Tier I capital to Tier I risk adjusted assets	9.40%	12.31%
Total risk-based capital to Tier II risk-adjusted assets	10.65%	13.56%
Leverage capital ratios:		
Tier I leverage capital to adjusted most recent quarter average assets	8.10%	10.66%

See "Supervision and Regulation" under "Business" above and Note 15 to the consolidated financial statements for discussion of other matters that may affect our capital resources.

Off-Balance Sheet Arrangements and Derivative Financial Instruments

Off-balance sheet arrangements include transactions, agreements, or other contractual arrangements pursuant to which we have obligations or provide guarantees on behalf of an unconsolidated entity. We have no off-balance sheet arrangements of this kind other than 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 derivatives activities through December 31, 2008 and have no current plans to do so.

Table of Contents

Return on Assets and Equity

Table 20 shows return on assets (net income divided by average total assets), return on equity (net income divided by average shareholders' equity), dividend payout ratio (dividends per share divided by net income per share) and shareholders' equity to assets ratio (average shareholders' equity divided by average total assets) for each of the years in the three-year period ended December 31, 2008.

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

Net interest income is our most significant component of earnings. Notwithstanding changes in volumes of loans and deposits, our level of net interest income is continually at risk due to the effect that changes in general market interest rate trends have on interest yields earned and paid with respect to our various categories of earning assets and interest-bearing liabilities. It is our policy to maintain portfolios of earning assets and interest-bearing liabilities with maturities and repricing opportunities that will afford protection, to the extent practical, against wide interest rate fluctuations. Our exposure to interest rate risk is analyzed on a regular basis by management using standard GAP reports, maturity reports, and an asset/liability software model that simulates future levels of interest income and expense based on current interest rates, expected future interest rates, and various intervals of "shock" interest rates. Over the years, we have been able to maintain a fairly consistent yield on average earning assets (net interest margin). Over the past five calendar years, our net interest margin has ranged from a low of 3.74% (realized in 2008) to a high of 4.33% (realized in 2005). During that five year period, the prime rate of interest has ranged from a low of 3.25% (which was the rate as of December 31, 2008) to a high of 8.25%. The consistency of the net interest margin is aided by the relatively low level of long-term interest rate exposure that we maintain. At December 31, 2008, approximately 93% of our interest-earning assets are subject to repricing within five years (because they are either adjustable rate assets or they are fixed rate assets that mature) and substantially all of our interest-bearing liabilities reprice within five years.

Table 17 sets forth our interest rate sensitivity analysis as of December 31, 2008, using stated maturities for all instruments except mortgage-backed securities (which are allocated in the periods of their expected payback) and securities and borrowings with call features that are expected to be called (which are shown in the period of their expected call). As illustrated by this table, at December 31, 2008, we had $723 million more in interest-bearing liabilities that are subject to interest rate changes within one year than earning assets. This generally would indicate that net interest income would experience downward pressure in a rising interest rate environment and would benefit from a declining interest rate environment. However, this method of analyzing interest sensitivity only measures the magnitude of the timing differences and does not address earnings, market value, or management actions. Also, interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. In addition to the effects of "when" various rate-sensitive products reprice, market rate changes may not result in uniform changes in rates among all products. For example, included in interest-bearing liabilities subject to interest rate changes within one year at December 31, 2008 are deposits totaling $665 million comprised of NOW, savings, and certain types of money market deposits with interest rates set by management. These types of deposits historically have not repriced with or in the same proportion as general market indicators.

Overall we believe that in the near term (twelve months), net interest income will not likely experience significant downward pressure from rising interest rates. Similarly, we would not expect a significant increase in near term net interest income from falling interest rates. Generally, when rates change, our interest-sensitive assets that are subject to adjustment reprice immediately at the full amount of the change, while our interest-sensitive liabilities that are subject to adjustment reprice at a lag to the rate change and typically not to the full extent of the rate change. In the short-term (less than six months), this results in our company 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

55

Table of Contents

discussion in this 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, as discussed in the following paragraph.

Prior to the interest rate decreases that began in September 2007, the Federal Reserve had increased the discount rate 17 times totaling 425 basis points beginning on July 1, 2004 and regularly thereafter until June 29, 2006. However, the impact of these rate increases did not have an equal effect on short-term interest rates and long-term interest rates in the marketplace. In the marketplace, short-term rates rose by a significantly higher amount than did longer-term interest rates. For example, from June 30, 2004 to December 31, 2006, the interest rate on three-month treasury bills rose by 369 basis points, whereas the interest rate for seven-year treasury notes increased by only 46 basis points. This resulted in what economists refer to as a "flat yield curve", which means that short-term interest rates were substantially the same as long-term interest rates. This is an unfavorable interest rate environment for many banks, including our company, as short-term interest rates generally drive our deposit pricing and longer-term interest rates generally drive loan pricing. When these rates converge, which they did in 2006, the profit spread we realize between loan yields and deposit rates narrows, which reduces our net interest margin. Due largely to the progressive flattening of the yield curve that occurred throughout 2006, our net interest margin decreased throughout 2006 before stabilizing at the lower levels in 2007 as a result of the relatively stable interest rate environment in effect for most of 2007. The net interest margin for 2007 was 4.00%, an 18 basis point decrease from 2006.

From September 2007 to December 2008, in response to the declining economy, the Federal Reserve continually reduced interest rates with rate decreases totaling 500 basis points and reaching historic lows. As noted above, our net interest margin is negatively impacted, at least in the short-term, by reductions in interest rates. In addition to the initial normal decline in net interest margin that we experience when interest rates are reduced (as discussed above), the cumulative impact of the magnitude of 500 basis points in interest rate cuts is expected to amplify and lengthen the negative impact on our net interest margin in 2009 and possibly beyond. This is primarily due to our inability to cut a large portion of our interest-bearing deposits by any significant amount due to their already near-zero interest rate. Also, for many of our deposit products, including time deposits that have recently matured, we have been unable to lower the interest rates we pay our customers by the full 500 basis point interest rate decrease due to competitive pressures. The impact of the declining rate environment was mitigated by an initiative we began in late 2007 to add interest rate floors to our adjustable rate loans. At December 31, 2008, adjustable rate loans totaling $411 million had reached their contractual floors and no longer subjected us to risk in the event of further rate cuts. As a result of these factors, our net interest margin declined for most of 2008 and was 3.74% for the full year, a 26 basis point decrease from the 4.00% margin realized in 2007.

In addition to the impact of the interest rate environment discussed above, our net interest margin was also negatively impacted by having more of our overall funding occurring in our highest cost funding sources. This trend was caused by aggressive pricing to attract funds to fund high loan growth, and by customers shifting their funds from low cost deposits to higher cost deposits.

Based on our most recent interest rate modeling, which assumes no changes in interest rates for 2009 (federal funds rate = 0.25%, prime = 3.25%), we project that our net interest margin will decline in the first quarter of 2009, due largely to the 75 basis point interest rate cut that occurred in December 2008, before gradually increasing for the remainder of the year as we are able to reset interest rates on maturing time deposits at lower levels. In addition to the assumption regarding interest rates, the aforementioned modeling is dependent on many other assumptions that could vary significantly from expectations, including, but not limited to: prepayment assumptions on fixed rate loans, loan growth, mix of loan growth, deposit growth, mix of deposit growth, and our ability to manage changes in rates earned on loans and paid on deposits, which will depend largely on actions taken by our competitors.

We have no market risk sensitive instruments held for trading purposes, nor do we maintain any foreign

Table of Contents

currency positions. Table 19 presents the expected maturities of our other than trading market risk sensitive financial instruments. Table 19 also presents the estimated fair values of market risk sensitive instruments as estimated in accordance with Statement of Financial Accounting Standards No. 107, “Disclosures About Fair Value of Financial Instruments.” Our assets and liabilities have estimated fair values that do not materially differ from their carrying amounts.

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

Inflation

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

Current Accounting and Regulatory Matters

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

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

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

Table of Contents

Table 1 Selected Consolidated Financial Data

($ in thousands, except per share and nonfinancial data)	Year Ended December 31, 2008	2007	2006	2005	2004
Income Statement Data					
Interest income	$ 147,862	148,942	129,207	101,429	81,593
Interest expense	61,303	69,658	54,671	32,838	20,303
Net interest income	86,559	79,284	74,536	68,591	61,290
Provision for loan losses	9,880	5,217	4,923	3,040	2,905
Net interest income after provision	76,679	74,067	69,613	65,551	58,385
Noninterest income	21,107	18,473	14,310	15,004	15,864
Noninterest expense	62,661	57,580	53,198	47,636	43,717
Income before income taxes	35,125	34,960	30,725	32,919	30,532
Income taxes	13,120	13,150	11,423	16,829	10,418
Net income	22,005	21,810	19,302	16,090	20,114
Earnings per share – basic	1.38	1.52	1.35	1.14	1.42
Earnings per share – diluted	1.37	1.51	1.34	1.12	1.40
Per Share Data					
Cash dividends declared	$ 0.76	0.76	0.74	0.70	0.66
Market Price					
High	20.86	26.72	23.90	27.88	29.73
Low	11.25	16.40	19.47	19.32	18.47
Close	18.35	18.89	21.84	20.16	27.17
Book value – stated	13.27	12.11	11.34	10.94	10.54
Tangible book value	9.18	8.56	7.76	7.48	7.04
Selected Balance Sheet Data (at year end)					
Total assets	$ 2,750,567	2,317,249	2,136,624	1,801,050	1,638,913
Loans	2,211,315	1,894,295	1,740,396	1,482,611	1,367,053
Allowance for loan losses	29,256	21,324	18,947	15,716	14,717
Intangible assets	67,780	51,020	51,394	49,227	49,330
Deposits	2,074,791	1,838,277	1,695,679	1,494,577	1,388,768
Borrowings	367,275	242,394	210,013	100,239	92,239
Total shareholders' equity	219,868	174,070	162,705	155,728	148,478
Selected Average Balances					
Assets	$ 2,484,296	2,139,576	1,922,510	1,709,380	1,545,332
Loans	2,117,028	1,808,219	1,623,188	1,422,419	1,295,682
Earning assets	2,329,025	1,998,428	1,793,811	1,593,554	1,434,425
Deposits	1,985,332	1,780,265	1,599,575	1,460,620	1,306,404

Interest-bearing liabilities	2,019,256	1,726,002	1,537,385	1,359,744	1,232,130
Shareholders' equity	210,810	170,857	163,193	154,871	146,683
Ratios					
Return on average assets	0.89%	1.02%	1.00%	0.94%	1.30%
Return on average equity	10.44%	12.77%	11.83%	10.39%	13.71%
Net interest margin (taxable-equivalent basis)	3.74%	4.00%	4.18%	4.33%	4.31%
Equity to assets at year end	7.99%	7.51%	7.62%	8.65%	9.06%
Tangible common equity to tangible assets	5.67%	5.43%	5.34%	6.08%	6.24%
Loans to deposits at year end	106.58%	103.05%	102.64%	99.20%	98.44%
Allowance for loan losses to total loans	1.32%	1.13%	1.09%	1.06%	1.08%
Nonperforming assets to total assets at year end	1.29%	0.47%	0.39%	0.17%	0.32%
Net charge-offs to average loans	0.24%	0.16%	0.11%	0.14%	0.14%
Efficiency ratio	57.85%	58.57%	59.54%	56.68%	56.32%
Nonfinancial Data					
Number of branches	74	70	68	61	59
Number of employees – Full time equivalents	650	614	620	578	563

58

Table of Contents

Table 2 Average Balances and Net Interest Income Analysis

	Year Ended December 31,								
	2008			2007			2006		
($ in thousands)	Average Volume	Avg. Rate	Interest Earned or Paid	Average Volume	Avg. Rate	Interest Earned or Paid	Average Volume	Avg. Rate	Interest Earned or Paid
Assets									
Loans (1)	$ 2,117,028	6.56%	$ 138,878	$ 1,808,219	7.70%	$ 139,323	$ 1,623,188	7.44%	$ 120,694
Taxable securities	152,246	4.82%	7,333	131,035	4.92%	6,453	118,032	4.84%	5,718
Non-taxable securities (2)	16,258	7.98%	1,298	13,786	8.09%	1,115	11,466	8.84%	1,014
Short-term investments, primarily overnight funds	43,493	2.32%	1,011	45,388	5.74%	2,605	41,125	5.55%	2,282
Total interest-earning assets	2,329,025	6.38%	148,520	1,998,428	7.48%	149,496	1,793,811	7.23%	129,708
Cash and due from banks	39,627			38,906			37,872		
Bank premises and equipment, net	49,815			45,398			38,592		
Other assets	65,829			56,844			52,235		
Total assets	$ 2,484,296			$ 2,139,576			$ 1,922,510		
Liabilities and Equity									
NOW accounts	$ 197,459	0.19%	$ 377	$ 192,407	0.37%	$ 712	$ 187,888	0.36%	$ 679
Money market accounts	309,917	2.36%	7,311	239,258	3.31%	7,929	183,751	2.71%	4,972
Savings accounts	124,460	1.65%	2,048	106,357	1.62%	1,727	111,909	1.29%	1,443
Time deposits >$100,000	532,566	4.00%	21,308	450,801	5.03%	22,687	390,246	4.53%	17,662
Other time deposits	586,235	3.79%	22,197	567,572	4.67%	26,498	520,140	4.09%	21,276
Total interest-bearing deposits	1,750,637	3.04%	53,241	1,556,395	3.83%	59,553	1,393,934	3.30%	46,032
Securities sold under agreements to repurchase	42,097	2.15%	903	39,220	3.76%	1,476	30,036	3.72%	1,116
Borrowings	226,522	3.16%	7,159	130,387	6.62%	8,629	113,415	6.63%	7,523
Total interest-bearing liabilities	2,019,256	3.04%	61,303	1,726,002	4.04%	69,658	1,537,385	3.56%	54,671
Non-interest-bearing deposits	234,695			223,870			205,641		

Other liabilities	19,535				18,847				16,291			
Shareholders' equity	210,810				170,857				163,193			
Total liabilities and shareholders' equity	$ 2,484,296				$ 2,139,576				$ 1,922,510			
Net yield on interest-earning assets and net interest income		3.74%	$	87,217		4.00%	$	79,838		4.18%	$	75,037
Interest rate spread		3.34%				3.44%				3.67%		
Average prime rate		5.09%				8.05%				7.96%		

(1) Average loans include nonaccruing loans, the effect of which is to lower the average rate shown. Interest earned includes recognized loan fees in the amounts of $405,000, $836,000, and $696,000 for 2008, 2007, and 2006, respectively.

(2) Includes tax-equivalent adjustments of $658,000, $554,000, and $501,000 in 2008, 2007, and 2006, respectively, to reflect the federal and state benefit of the tax-exempt securities (using a 39% combined tax rate), reduced by the related nondeductible portion of interest expense.

Table of Contents

Table 3 Volume and Rate Variance Analysis

	Year Ended December 31, 2008 Change Attributable to			Year Ended December 31, 2007 Change Attributable to		
(In thousands)	Changes in Volumes	Changes in Rates	Total Increase (Decrease)	Changes in Volumes	Changes in Rates	Total Increase (Decrease)
Interest income (tax-equivalent):						
Loans	$ 22,026	(22,471)	(445)	14,007	4,622	18,629
Taxable securities	1,033	(153)	880	635	100	735
Non-taxable securities	199	(16)	183	196	(95)	101
Short-term investments, primarily overnight funds	(76)	(1,518)	(1,594)	241	82	323
Total interest income	23,182	(24,158)	(976)	15,079	4,709	19,788
Interest expense:						
NOW accounts	14	(349)	(335)	17	16	33
Money Market accounts	2,004	(2,622)	(618)	1,671	1,286	2,957
Savings accounts	296	25	321	(81)	365	284
Time deposits>$100,000	3,693	(5,072)	(1,379)	2,894	2,131	5,025
Other time deposits	789	(5,090)	(4,301)	2,077	3,145	5,222
Total interest-bearing deposits	6,796	(13,108)	(6,312)	6,578	6,943	13,521
Securities sold under agreements to repurchase	85	(658)	(573)	343	17	360
Borrowings	4,700	(6,170)	(1,470)	1,124	(18)	1,106
Total interest expense	11,581	(19,936)	(8,355)	8,045	6,942	14,987
Net interest income (tax-equivalent)	$ 11,601	(4,222)	7,379	7,034	(2,233)	4,801

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

Table 4 Noninterest Income

	Year Ended December 31,		
(In thousands)	2008	2007	2006
Service charges on deposit accounts	$ 13,535	9,988	8,968
Other service charges, commissions, and fees	4,842	5,158	4,578
Fees from presold mortgages	869	1,135	1,062
Commissions from sales of insurance and financial products	1,552	1,511	1,434
Data processing fees	167	204	162
Total core noninterest income	20,965	17,996	16,204
Securities gains (losses), net	(14)	487	205
Other gains (losses), net	156	(10)	(2,099)
Total	$ 21,107	18,473	14,310

Table 5 Noninterest Expenses

(In thousands)	Year Ended December 31, 2008	2007	2006
Salaries	$ 28,127	26,227	23,867
Employee benefits	7,319	7,443	6,811
Total personnel expense	35,446	33,670	30,678
Occupancy expense	4,175	3,795	3,447
Equipment related expenses	4,105	3,809	3,419
Amortization of intangible assets	416	374	322
Stationery and supplies	1,903	1,593	1,675
Telephone	1,349	1,246	1,273
Non-credit losses	200	204	165
Other operating expenses	15,067	12,889	12,219
Total	$ 62,661	57,580	53,198

Table of Contents

Table 6 Income Taxes

(In thousands)		2008	2007	2006
Current - Federal	$	11,978	11,625	10,809
- State		1,962	1,938	1,927
Deferred - Federal		(703)	(348)	(1,112)
- State		(117)	(65)	(201)
Total	$	13,120	13,150	11,423
Effective tax rate		37.4%	37.6%	37.2%

Table 7 Distribution of Assets and Liabilities

	As of December 31,		
	2008	2007	2006
Assets			
Interest-earning assets			
Net loans	80%	81%	80%
Securities available for sale	6	6	6
Securities held to maturity	1	1	1
Short term investments	5	6	5
Total interest-earning assets	92	94	92
Noninterest-earning assets			
Cash and due from banks	3	1	2
Premises and equipment	2	2	2
Other assets	3	3	4
Total assets	100%	100%	100%
Liabilities and shareholders' equity			
Demand deposits – noninterest bearing	8%	10%	10%
NOW deposits	7	8	9
Money market deposits	12	11	9
Savings deposits	5	4	5
Time deposits of $100,000 or more	22	21	20
Other time deposits	22	25	26
Total deposits	76	79	79
Securities sold under agreements to repurchase	2	2	2
Borrowings	13	10	10
Accrued expenses and other liabilities	1	1	1
Total liabilities	92	92	92
Shareholders' equity	8	8	8
Total liabilities and shareholders' equity	100%	100%	100%