FIRST BANCORP /NC/
Form 10-Q
May 10, 2007

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

FORM 10-Q

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

For the quarterly period ended March 31, 2007

Commission File Number 0-15572

FIRST BANCORP
(Exact Name of Registrant as
Specified in its Charter)

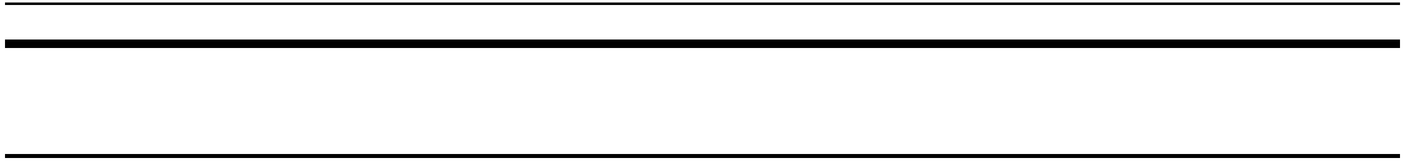
North Carolina (State or Other Jurisdiction of Incorporation or Organization)	56-1421916 (I.R.S. Employer Identification Number)
341 North Main Street, Troy, North Carolina (Address of Principal Executive Offices)	27371-0508 (Zip Code)
(Registrant's telephone number, including area code)	(910) 576-6171

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x YES o NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. o Large Accelerated Filer x Accelerated Filer o Non-Accelerated Filer

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

The number of shares of the registrant's Common Stock outstanding on April 30, 2007 was 14,380,003.



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Part I. Financial Information
Item 1 - Financial Statements

First Bancorp and Subsidiaries
Consolidated Balance Sheets

($ in thousands-unaudited)	**March 31, 2007**	December 31, 2006 (audited)	March 31, 2006
ASSETS			
Cash and due from banks, noninterest-bearing	**$ 20,355**	43,248	32,687
Due from banks, interest-bearing	**99,067**	83,877	82,331
Federal funds sold	**35,061**	19,543	25,294
Total cash and cash equivalents	**154,483**	146,668	140,312
Securities available for sale (costs of $127,229, $130,824, and $113,838)	**126,634**	129,964	112,695
Securities held to maturity (fair values of $13,651, $13,168, and $12,551)	**13,607**	13,122	12,455
Presold mortgages in process of settlement	**4,089**	4,766	2,086
Loans	**1,776,130**	1,740,396	1,553,371
Less: Allowance for loan losses	**(19,478)**	(18,947)	(16,610)
Net loans	**1,756,652**	1,721,449	1,536,761
Premises and equipment	**44,627**	43,540	35,339
Accrued interest receivable	**11,341**	12,158	8,993
Goodwill	**49,505**	49,505	47,247
Other intangible assets	**1,795**	1,889	1,884
Other	**14,549**	13,563	10,115
Total assets	**$ 2,177,282**	2,136,624	1,907,887
LIABILITIES			
Deposits: Demand - noninterest-bearing	**$ 225,644**	217,291	213,661
Savings, NOW, and money market	**524,381**	502,775	473,655
Time deposits of $100,000 or more	**434,336**	422,772	372,232
Other time deposits	**561,232**	552,841	505,492
Total deposits	**1,745,593**	1,695,679	1,565,040
Securities sold under agreements to repurchase	**49,440**	43,276	32,939
Borrowings	**198,013**	210,013	131,739
Accrued interest payable	**5,806**	5,649	4,312
Other liabilities	**13,271**	19,302	14,886

Total liabilities	**2,012,123**	1,973,919	1,748,916
SHAREHOLDERS' EQUITY			
Common stock, no par value per share			
Issued and outstanding: 14,367,868, 14,352,884, and 14,291,060 shares	**56,115**	56,035	54,994
Retained earnings	**113,376**	111,220	104,926
Accumulated other comprehensive income (loss)	**(4,332)**	(4,550)	(949)
Total shareholders' equity	**165,159**	162,705	158,971
Total liabilities and shareholders' equity	**$ 2,177,282**	2,136,624	1,907,887

See notes to consolidated financial statements.

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First Bancorp and Subsidiaries
Consolidated Statements of Income

($ in thousands, except share data-unaudited)	Three Months Ended March 31, 2007	2006
INTEREST INCOME		
Interest and fees on loans	$ **33,211**	26,762
Interest on investment securities:		
Taxable interest income	**1,539**	1,329
Tax-exempt interest income	**133**	127
Other, principally overnight investments	**653**	497
Total interest income	**35,536**	28,715
INTEREST EXPENSE		
Savings, NOW and money market	**2,257**	1,333
Time deposits of $100,000 or more	**5,336**	3,677
Other time deposits	**6,386**	4,432
Securities sold under agreements to repurchase	**412**	262
Borrowings	**2,279**	1,158
Total interest expense	**16,670**	10,862
Net interest income	**18,866**	17,853
Provision for loan losses	**1,121**	1,015
Net interest income after provision for loan losses	**17,745**	16,838
NONINTEREST INCOME		
Service charges on deposit accounts	**2,177**	2,074
Other service charges, commissions and fees	**1,259**	1,205
Fees from presold mortgages	**327**	267
Commissions from sales of insurance and financial products	**459**	439
Data processing fees	**47**	36
Securities gains	**-**	-
Other gains (losses)	**(33)**	(67)
Total noninterest income	**4,236**	3,954
NONINTEREST EXPENSES		
Salaries	**6,343**	5,785
Employee benefits	**1,778**	1,781
Total personnel expense	**8,121**	7,566
Net occupancy expense	**938**	816
Equipment related expenses	**938**	811
Intangibles amortization	**94**	61
Other operating expenses	**4,039**	3,475
Total noninterest expenses	**14,130**	12,729
Income before income taxes	**7,851**	8,063

Income taxes		**2,965**	3,072
NET INCOME	**$**	**4,886**	4,991
Earnings per share:			
Basic	**$**	**0.34**	0.35
Diluted		**0.34**	0.35
Weighted average common shares outstanding:			
Basic		**14,360,111**	14,254,785
Diluted		**14,492,159**	14,421,639

See notes to consolidated financial statements.

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First Bancorp and Subsidiaries
Consolidated Statements of Comprehensive Income

($ in thousands-unaudited)	Three Months Ended March 31, **2007**	2006
Net income	**$ 4,886**	4,991
Other comprehensive income (loss):		
Unrealized gains (losses) on securities available for sale:		
Unrealized holding gains (losses) arising during the period, pretax	**265**	(96)
Tax benefit (expense)	**(104)**	37
Pension adjustments:		
Pension adjustment related to unfunded pension liability	**-**	16
Tax expense	**-**	(6)
Amortization of prior service cost, actuarial loss and transition obligation	**93**	-
Tax expense	**(36)**	-
Other comprehensive income (loss)	**218**	(49)
Comprehensive income	**$ 5,104**	4,942

See notes to consolidated financial statements.

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First Bancorp and Subsidiaries
Consolidated Statements of Shareholders' Equity

(In thousands, except per share - unaudited)	Common Stock Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Share-holders' Equity
Balances, January 1, 2006	14,229	$ 54,121	102,507	(900)	155,728
Net income			4,991		4,991
Cash dividends declared ($0.18 per share)			(2,572)		(2,572)
Common stock issued under stock option plan	44	429			429
Common stock issued into dividend reinvestment plan	18	397			397
Stock-based compensation	-	47			47
Other comprehensive loss				(49)	(49)
Balances, March 31, 2006	14,291	$ 54,994	104,926	(949)	158,971
Balances, January 1, 2007	**14,353**	**$ 56,035**	**111,220**	**(4,550)**	**162,705**
Net income			**4,886**		**4,886**
Cash dividends declared ($0.19 per share)			**(2,730)**		**(2,730)**
Common stock issued under stock option plan	**15**	**76**			**76**
Purchases and retirement of common stock	**-**	**(8)**			**(8)**
Stock-based compensation	**-**	**12**			**12**
Other comprehensive income				**218**	**218**
Balances, March 31, 2007	**14,368**	**$ 56,115**	**113,376**	**(4,332)**	**165,159**

See notes to consolidated financial statements.

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First Bancorp and Subsidiaries
Consolidated Statements of Cash Flows

($ in thousands-unaudited)	Three Months Ended March 31, **2007**	2006
Cash Flows From Operating Activities		
Net income	**$ 4,886**	4,991
Reconciliation of net income to net cash provided by operating activities:		
Provision for loan losses	**1,121**	1,015
Net security premium amortization	**6**	21
Other losses	**33**	67
Decrease in net deferred loan fees and costs	**18**	107
Depreciation of premises and equipment	**802**	688
Stock-based compensation expense	**12**	47
Amortization of intangible assets	**94**	61
Deferred income tax benefit	**(280)**	(416)
Origination of presold mortgages in process of settlement	**(18,614)**	(15,623)
Proceeds from sales of presold mortgages in process of settlement	**19,291**	16,884
Decrease (increase) in accrued interest receivable	**817**	(46)
Increase in other assets	**(7)**	(62)
Increase in accrued interest payable	**157**	477
Increase (decrease) in other liabilities	**(5,941)**	1,778
Net cash provided by operating activities	**2,395**	9,989
Cash Flows From Investing Activities		
Purchases of securities available for sale	**(13,233)**	(6,495)
Purchases of securities held to maturity	**(910)**	(1,968)
Proceeds from maturities/issuer calls of securities available for sale	**16,741**	7,300
Proceeds from maturities/issuer calls of securities held to maturity	**421**	751
Net increase in loans	**(37,139)**	(71,238)
Purchases of premises and equipment	**(1,879)**	(1,187)
Net cash used by investing activities	**(35,999)**	(72,837)
Cash Flows From Financing Activities		
Net increase in deposits and repurchase agreements	**56,078**	69,872
Proceeds from (repayments of) borrowings, net	**(12,000)**	31,500
Cash dividends paid	**(2,727)**	(2,561)
Proceeds from issuance of common stock	**76**	826
Purchases and retirement of common stock	**(8)**	-
Net cash provided by financing activities	**41,419**	99,637
Increase in cash and cash equivalents	**7,815**	36,789
Cash and cash equivalents, beginning of period	**146,668**	103,523
Cash and cash equivalents, end of period	**$ 154,483**	140,312

Supplemental Disclosures of Cash Flow Information:		
Cash paid during the period for:		
Interest	$ **16,513**	10,385
Income taxes	**7,097**	1,243
Non-cash transactions:		
Unrealized gain (loss) on securities available for sale, net of taxes	**161**	(59)
Foreclosed loans transferred to other real estate	**802**	250

See notes to consolidated financial statements.

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First Bancorp and Subsidiaries
Notes to Consolidated Financial Statements

(*unaudited*) For the Periods Ended March 31, 2007 and 2006

Note 1 - Basis of Presentation

In the opinion of the Company, the accompanying unaudited consolidated financial statements contain all adjustments necessary to present fairly the consolidated financial position of the Company as of March 31, 2007 and 2006 and the consolidated results of operations and consolidated cash flows for the periods ended March 31, 2007 and 2006. Reference is made to the 2006 Annual Report on Form 10-K filed with the SEC for a discussion of accounting policies and other relevant information with respect to the financial statements. The results of operations for the periods ended March 31, 2007 and 2006 are not necessarily indicative of the results to be expected for the full year.

Note 2 – Accounting Policies

Note 1 to the 2006 Annual Report on Form 10-K filed with the SEC contains a description of the accounting policies followed by the Company and discussion of recent accounting pronouncements. The following paragraphs update that information as necessary.

In July 2006, the Financial Accounting Standards Board (FASB) released FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109" (FIN 48). FIN 48 clarifies the accounting and reporting for uncertainties in income tax law. FIN 48 prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. The cumulative effect of applying the provisions of this interpretation is required to be reported separately as an adjustment to the opening balance of retained earnings in the year of adoption. The Company's adoption of FIN 48 in the first quarter of 2007 did not impact the Company's consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, "Fair Value Measurements" (Statement 157). Statement 157 provides enhanced guidance for using fair value to measure assets and liabilities. The standard also requires expanded disclosures about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. Statement 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company does not expect the adoption of Statement 157 to materially impact the Company's consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115" (Statement 159). This statement permits, but does not require, entities to measure many financial instruments at fair value. The objective is to provide entities with an opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Entities electing this option will apply it when the entity first recognizes an eligible instrument and will report unrealized gains and losses on such instruments in current earnings. This statement 1) applies to all entities, 2) specifies certain election dates, 3) can be applied on an instrument-by-instrument basis with some exceptions, 4) is irrevocable and 5) applies only to entire instruments. One exception is demand deposit liabilities which are explicitly excluded as qualifying for fair value. With respect to SFAS 115, available for sale and held to maturity securities at the effective date are eligible for the fair value option at

that date. If the fair value option is elected for those securities at the effective date, cumulative unrealized gains and losses at that date shall be included in the cumulative-effect adjustment and thereafter, such securities will be accounted for as trading securities. Statement

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159 is effective for the Company on January 1, 2008. Earlier adoption is permitted in 2007 if the Company also elects to apply the provisions of Statement 157. The Company did not early adopt Statement 159 and believes that it is unlikely that it will expand its use of fair value accounting upon the January 1, 2008 effective date.

Note 3 – Reclassifications

Certain amounts reported in the period ended March 31, 2006 have been reclassified to conform to the presentation for March 31, 2007. These reclassifications had no effect on net income or shareholders' equity for the periods presented, nor did they materially impact trends in financial information.

Note 4 – Equity-Based Compensation Plans

At March 31, 2007, the Company had the following equity-based compensation plans, all of which are stock option plans: the First Bancorp 2004 Stock Option Plan, the First Bancorp 1994 Stock Option Plan, and four plans that were assumed from acquired entities, which are all described below. The Company's shareholders approved all equity-based compensation plans, except for those assumed from acquired companies. As of March 31, 2007, the First Bancorp 2004 Stock Option Plan was the only plan that had shares available for future grants.

The First Bancorp 2004 Stock Option Plan and its predecessor plan, the First Bancorp 1994 Stock Option Plan, were intended to serve as a means of attracting, retaining and motivating key employees and directors and to associate the interests of the plans' participants with those of the Company and its shareholders. Stock option grants to non-employee directors have historically had no vesting requirements, whereas, except as discussed below, stock option grants to employees have generally had five-year vesting schedules (20% vesting each year). In April 2004, the Company's Compensation Committee granted 128,000 options to employees with no vesting requirements. These options were granted without any vesting requirements for two reasons - 1) the options were granted primarily as a reward for past performance and therefore had already been "earned" in the view of the Committee, and 2) to potentially minimize the impact that any change in accounting standards for stock options could have on future years' reported net income. Employee stock option grants since the April 2004 grant have reverted to having five year vesting periods. The Company's options provide for immediate vesting if there is a change in control (as defined in the plans). Under the terms of these two plans, options can have a term of no longer than ten years, and all options granted thus far under these plans have had a term of ten years. Except for grants to directors (see below), the Company cannot estimate the amount of future stock option grants at this time. In the past, stock option grants to employees have been irregular, generally falling into three categories - 1) to attract and retain new employees, 2) to recognize changes in responsibilities of existing employees, and 3) to periodically reward exemplary performance. As it relates to directors, the Company has historically granted 2,250 stock options to each of the Company's non-employee directors in June of each year, and expects to continue doing so for the foreseeable future. At March 31, 2007, there were 596,021 options outstanding related to these two plans with exercise prices ranging from $9.75 to $22.12. At March 31, 2007, there were 1,180,250 shares remaining available for grant under the First Bancorp 2004 Stock Option Plan.

The Company also has four stock option plans as a result of assuming plans of acquired companies. At March 31, 2007, there were 35,421 stock options outstanding in connection with these plans, with option prices ranging from $10.22 to $11.49.

The Company issues new shares when options are exercised.

Prior to January 1, 2006, the Company accounted for all of these plans using the intrinsic value method prescribed by APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. Because all of the Company's stock options had an exercise price equal to the market value of the underlying common stock on the date

of grant, no compensation cost had ever been recognized. On January 1, 2006, the Company adopted Statement No. 123(R), *Share-Based Payment*. Statement 123(R) supersedes Opinion 25 (and related interpretations) and requires that the compensation cost relating to share-based payment transactions be recognized in the financial statements. Statement 123(R) permitted public companies to adopt its requirements using one of two methods. The "modified prospective" method recognizes compensation for all

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stock options granted after the date of adoption and for all previously granted stock options that become vested after the date of adoption. The "modified retrospective" method includes the requirements of the "modified prospective" method described above, but also permits entities to restate prior period results based on the amounts previously presented under Statement 123 for purposes of pro-forma disclosures. The Company elected to adopt Statement 123(R) under the "modified prospective" method and accordingly did not restate prior period results.

The Company measures the fair value of each option award on the date of grant using the Black-Scholes option-pricing model. The Company determines the assumptions used in the Black-Scholes option pricing model as follows: the risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of the grant; the dividend yield is based on the Company's dividend yield at the time of the grant (subject to adjustment if the dividend yield on the grant date is not expected to approximate the dividend yield over the expected life of the option); the volatility factor is based on the historical volatility of the Company's stock (subject to adjustment if future volatility is reasonably expected to differ from the past); the weighted-average expected life is based on the historical behavior of employees related to exercises, forfeitures and cancellations.

In the first quarter of 2007 and 2006, the adoption of Statement 123(R) resulted in stock-based compensation expense of $12,000 and $47,000, respectively, with no associated tax benefits, which was classified as "salaries expense" on the Consolidated Statements of Income and reduced both income before income taxes and net income by that same amount. This compensation expense was reflected as an adjustment to cash flows from operating activities on the Company's Consolidated Statement of Cash Flows. At March 31, 2007, the Company had $45,000 of unrecognized compensation costs related to unvested stock options. The cost is expected to be amortized over a weighted-average life of 1.55 years, with $36,000 being expensed during the remainder of 2007 equally distributed among the three remaining quarters, and $3,000 being expensed in each of 2008, 2009 and 2010, equally distributed among each of the four quarters of each year. In addition, as discussed above, the Company expects to grant 2,250 options, without vesting requirements, to each of its non-employee directors on June 1, 2007 and on June 1 of each year thereafter.

As noted above, certain of the Company's stock option grants contain terms that provide for a graded vesting schedule whereby portions of the award vest in increments over the requisite service period. As provided for under Statement 123(R), the Company has elected to recognize compensation expense for awards with graded vesting schedules on a straight-line basis over the requisite service period for the entire award. Statement 123(R) requires companies to recognize compensation expense based on the estimated number of stock options and awards for which service is to be rendered. Over the past five years, there have been only nine forfeitures or expirations, totaling 13,500 options, and therefore the Company assumes that all options granted will become vested.

There were no option grants during the first quarters of 2006 or 2007.

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The following table presents information regarding the activity during the first three months of 2007 related to all of the Company's stock options outstanding:

Three months ended March 31, 2007	All Options Outstanding Number of Shares		Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term		Aggregate Intrinsic Value ($000)
Outstanding at the beginning of the period	656,104	$	16.94			
Granted during the period	-		-			
Exercised during the period	24,662		12.28			
Forfeited or expired during the period	-		-			
Outstanding at end of period	631,442	$	17.12	5.2	$	2,688
Exercisable at March 31, 2007	620,442	$	17.13	5.1	$	2,638

The Company received $76,000 and $429,000 as a result of stock option exercises during the three months ended March 31, 2007 and 2006, respectively. The intrinsic value of the stock options exercised during the three months ended March 31, 2007 and 2006 was $290,000 and $527,000, respectively. No nonqualified stock options were exercised during the first quarters of 2007 or 2006, and thus the Company did not record any associated tax benefits.

Note 5 – Earnings Per Share

Basic earnings per share were computed by dividing net income by the weighted average common shares outstanding. Diluted earnings per share includes the potentially dilutive effects of the Company's stock option plan. The following is a reconciliation of the numerators and denominators used in computing basic and diluted earnings per share:

($ in thousands except per share amounts)	For the Three Months Ended March 31, **2007** **Income (Numer-ator)**	**Shares (Denom-inator)**	**Per Share Amount**	2006 Income (Numer-ator)	Shares (Denom-inator)	Per Share Amount
Basic EPS						
Net income	**$ 4,886**	**14,360,111**	**$ 0.34**	$ 4,991	14,254,785	$ 0.35
Effect of Dilutive Securities	**-**	**132,048**		-	166,854	
Diluted EPS	**$ 4,886**	**14,492,159**	**$ 0.34**	$ 4,991	14,421,639	$ 0.35

For the three months ended March 31, 2007, there were no options in which the exercise price exceeded the average market price for the period ("antidilutive"). For the three months ended March 31, 2006, there were 191,730 antidilutive options, and these options were excluded from the calculation of the effect of dilutive securities.

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Note 6 – Asset Quality Information

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

($ in thousands)	**March 31, 2007**	December 31, 2006	March 31, 2006
Nonperforming loans:			
Nonaccrual loans	**$ 5,871**	6,852	3,283
Restructured loans	**8**	10	12
Accruing loans> 90 days past due	–	–	–
Total nonperforming loans	**5,879**	6,862	3,295
Other real estate	**2,351**	1,539	1,451
Total nonperforming assets	**$ 8,230**	8,401	4,746
Nonperforming loans to total loans	**0.33%**	0.39%	0.21%
Nonperforming assets as a percentage of loans and other real estate	**0.46%**	0.48%	0.31%
Nonperforming assets to total assets	**0.38%**	0.39%	0.25%
Allowance for loan losses to total loans	**1.10%**	1.09%	1.07%

Note 7 – Deferred Loan Fees

Loans are shown on the Consolidated Balance Sheets net of net deferred loan costs of approximately $9,000, $27,000, and $76,000 at March 31, 2007, December 31, 2006, and March 31, 2006, respectively.

Note 8 – Goodwill and Other Intangible Assets

The following is a summary of the gross carrying amount and accumulated amortization of amortizable intangible assets as of March 31, 2007, December 31, 2006, and March 31, 2006 and the carrying amount of unamortized intangible assets as of those same dates.

	March 31, 2007		December 31, 2006		March 31, 2006	
($ in thousands)	**Gross Carrying Amount**	**Accumulated Amortization**	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortizable intangible assets:						
Customer lists	**$ 394**	**156**	394	148	394	123
Core deposit premiums	**2,945**	**1,388**	2,945	1,302	2,441	1,064
Total	**$ 3,339**	**1,544**	3,339	1,450	2,835	1,187

Unamortizable intangible assets:			
Goodwill	**$ 49,505**	49,505	47,247
Pension	$ –	–	237

Amortization expense totaled $94,000 and $61,000 for the three months ended March 31, 2007 and 2006, respectively.

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The following table presents the estimated amortization expense for each of the five calendar years ending December 31, 2011 and the estimated amount amortizable thereafter. These estimates are subject to change in future periods to the extent management determines it is necessary to make adjustments to the carrying value or estimated useful lives of amortized intangible assets.

(Dollars in thousands)	Estimated Amortization Expense
2007	$ 374
2008	316
2009	279
2010	262
2011	247
Thereafter	411
Total	$ 1,889

Note 9 – Pension Plans

The Company sponsors two defined benefit pension plans – a qualified retirement plan (the "Pension Plan"), which is generally available to all employees, and a Supplemental Executive Retirement Plan (the "SERP Plan"), which is for the benefit of certain senior management executives of the Company.

The Company recorded pension expense totaling $516,000 and $581,000 for the three months ended March 31, 2007 and 2006, respectively, related to the Pension Plan and the SERP Plan. The following table contains the components of the pension expense.

	For the Three Months Ended March 31,					
(in thousands)	2007 Pension Plan	2006 Pension Plan	2007 SERP Plan	2006 SERP Plan	2007 Total Both Plans	2006 Total Both Plans
Service cost – benefits earned during the period	$ 347	341	83	79	430	420
Interest cost	254	227	58	52	312	279
Expected return on plan assets	(319)	(268)	-	-	(319)	(268)
Amortization of Transition Obligation	-	1	-	-	-	1
Amortization of net (gain)/loss	62	112	19	22	81	134
Amortization of prior service cost	3	6	9	9	12	15
Net periodic pension cost	$ 347	419	169	162	516	581

The Company's contributions to the Pension Plan are based on computations by independent actuarial consultants and are intended to ensure that the Pension Plan exceeds minimum funding standards at all times according to standards established by the Internal Revenue Service. The contributions are invested to provide for benefits under the Pension

Plan. The Company estimates that its contribution to the Pension Plan will be $1,000,000 during 2007.

The Company's funding policy with respect to the SERP Plan is to fund the related benefits primarily from the operating cash flow of the Company. The Company estimates that its payments to participants in the SERP Plan will be $184,000 in 2007.

Note 10 – Settlement of Tax Liability

In March 2007, the Company completed its participation in the North Carolina Department of Revenue's Settlement Initiative by paying the state $6.9 million to settle a tax matter. See page 31, "Income Taxes," of the Company's 2006 SEC Form 10-K for background discussion of this issue.

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Item 2 - Management's Discussion and Analysis of Consolidated Results of Operations and Financial Condition

CRITICAL ACCOUNTING POLICIES

The accounting principles followed by the Company and the 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/or use of estimates based on the Company’s best assumptions at the time of the estimation. The Company has identified three policies as being more sensitive in terms of judgments and estimates, taking into account their overall potential impact to the Company’s consolidated financial statements – 1) the allowance for loan losses, 2) tax uncertainties, and 3) intangible assets.

Allowance for Loan Losses

Due to the estimation process and the potential materiality of the amounts involved, the Company has identified the accounting for the allowance for loan losses and the related provision for loan losses as an accounting policy critical to the Company’s 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.

Management’s 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 the Company 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 the Company expects to receive from the borrower discounted at the loan’s effective rate, or 2) in the case of a collateral-dependent loan, the fair value of the collateral.

The second component of the allowance model is to estimate losses for all loans not considered to be impaired loans. First, loans that have been risk graded by the Company 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 are classified by the Company 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 the Company’s “allocated allowance.” In addition to the allocated allowance derived from the model, management also evaluates 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, the Company may determine that an additional amount of allowance for loan losses is necessary to reserve for probable losses. This additional amount, if any, is the Company’s “unallocated allowance.” The sum of the allocated allowance and the unallocated allowance is compared to the actual allowance for loan losses recorded on the books of the Company 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 management uses the best information available to make evaluations, future 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 the Company’s allowance for loan losses. Such agencies may require

the Company to recognize additions to the allowance based on the examiners' judgment about information available to them at the time of their examinations.

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

Tax Uncertainties

The Company reserves for tax uncertainties in instances when it has taken a position on a tax return that may differ from the opinion of the applicable taxing authority. In accounting for tax contingencies, the Company assesses the relative merits and risks of certain tax transactions, taking into account statutory, judicial and regulatory guidance in the context of the Company's tax position. For those matters where it is probable that the Company will have to pay additional taxes, interest or penalties and a loss or range of losses can be reasonably estimated, the Company records reserves in the consolidated financial statements. For those matters where it is reasonably possible but not probable that the Company will have to pay additional taxes, interest or penalties and the loss or range of losses can be reasonably estimated, the Company only makes disclosures in the notes and does not record reserves in the consolidated financial statements. The process of concluding that a loss is reasonably possible or probable and estimating the amount of loss or range of losses and related tax reserves is inherently subjective and future changes to the reserve may be necessary based on changes in management's intent, tax law or related interpretations, or other functions.

Intangible Assets

Due to the estimation process and the potential materiality of the amounts involved, the Company has also identified the accounting for intangible assets as an accounting policy critical to the Company’s consolidated financial statements.

When the Company completes 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. The Company 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 the Company’s future earnings to have a lower amount assigned to identifiable intangible assets and higher amount of goodwill as opposed to having a higher amount considered to be identifiable intangible assets and a lower amount classified as goodwill.

For the Company, the primary identifiable intangible asset typically recorded in connection with a whole bank or bank branch acquisition is the value of the core deposit intangible, whereas when the Company acquires 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. The Company typically engages 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 goodwi