the little bank

2013 Audited Financial Statements

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DIXON HUGHES GOODMAN LLP
Certified Public Accountants and Advisors

INDEPENDENT AUDITORS' REPORT

To the Stockholders and the Board of Directors
the little bank
Kinston, North Carolina

We have audited the accompanying financial statements of **the little bank** (the "Bank"), which comprise the balance sheets as of December 31, 2013 and 2012, and the related statements of operations, comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility
Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of **the little bank** at December 31, 2013 and 2012 and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Dixon Hughes Goodman LLP

Greenville, North Carolina
April 9, 2014

the little bank

BALANCE SHEETS

December 31, 2013 and 2012

ASSETS	2013	2012
Cash and due from banks	$ 5,896,512	$ 6,266,473
Interest-earning deposits with banks	3,357,500	4,935,091
Federal funds sold	467,222	1,225,312
Certificates of deposit with banks	2,205,000	2,205,000
Investment securities available for sale (Note C)	65,912,904	67,615,209
Loans (Note D)	222,829,869	214,728,321
Allowance for loan losses	(3,850,004)	(4,073,047)
NET LOANS	218,979,865	210,655,274
Accrued interest receivable	815,250	866,727
Federal Home Loan Bank stock	1,267,300	1,526,700
Bank premises and equipment, net	3,464,453	3,534,452
Bank-owned life insurance	7,216,364	5,028,727
Real estate owned	519,660	536,583
Other assets	1,857,007	1,487,467
TOTAL ASSETS	$ 311,959,037	$ 305,883,015
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits	$ 261,393,367	$ 250,097,884
Advances from the Federal Home Loan Bank, short term	10,500,000	9,500,000
Advances from the Federal Home Loan Bank, long term	9,500,000	14,000,000
Accrued interest payable	85,037	107,863
Accrued expenses and other liabilities	752,855	451,603
TOTAL LIABILITIES	282,231,259	274,157,350
Commitments (Note D and K)		
Stockholders' Equity:		
Non-cumulative perpetual preferred stock (Series A), no par value, 2,800 shares authorized, issued and outstanding at December 31, 2012	-	2,761,787
Non-cumulative perpetual preferred stock (Series B), no par value, 1 share authorized, issued and outstanding at December 31, 2012	-	1,045
Common stock, no par value, 24,000,000 shares authorized; 2,969,948 and 2,824,390 shares issued and outstanding at December 31, 2013 and 2012, respectively	27,106,834	25,572,863
Retained earnings	3,197,858	2,657,803
Accumulated other comprehensive income (loss)	(576,914)	732,167
TOTAL STOCKHOLDERS' EQUITY	29,727,778	31,725,665
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 311,959,037	$ 305,883,015

See accompanying notes.

the little bank

STATEMENTS OF OPERATIONS

Years Ended December 31, 2013 and 2012

	2013	2012
INTEREST INCOME		
Loans	$ 10,731,764	$ 11,081,484
Investment securities	1,183,661	1,567,394
Federal funds sold	3,792	5,055
Interest-bearing deposits with banks	30,469	15,952
TOTAL INTEREST INCOME	11,949,686	12,669,885
INTEREST EXPENSE		
Money market, NOW and savings deposits	244,440	261,747
Time deposits	1,215,592	1,642,080
Advances from the Federal Home Loan Bank	176,344	225,292
TOTAL INTEREST EXPENSE	1,636,376	2,129,119
NET INTEREST INCOME	10,313,310	10,540,766
(RECOVERY) PROVISION FOR LOAN LOSSES	(57,000)	815,000
NET INTEREST INCOME AFTER (RECOVERY) PROVISION FOR LOAN LOSSES	10,370,310	9,725,766
NONINTEREST INCOME		
Service charges and fees on deposit accounts	432,832	444,359
Fees from presold mortgages	289,911	356,970
Debit card interchange fees	341,097	307,847
Income from bank owned life insurance	187,637	182,298
Gain on sales of investment securities available for sale	59,042	80,485
Other	44,468	55,545
TOTAL NONINTEREST INCOME	1,354,987	1,427,504
NONINTEREST EXPENSE		
Salaries and employee benefits	4,521,993	4,173,362
Occupancy and equipment	730,470	663,411
Data processing	797,190	692,095
Marketing	140,621	150,467
Other (Note P)	1,352,964	1,654,793
TOTAL NONINTEREST EXPENSE	7,543,238	7,334,128
INCOME BEFORE INCOME TAXES	4,182,059	3,819,142
INCOME TAXES	1,394,000	1,351,000
NET INCOME	2,788,059	2,468,142
PREFERRED STOCK DIVIDENDS	(78,226)	(398,323)
ACCRETION OF DISCOUNT, NET	(38,168)	(127,232)
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS	$ 2,671,665	$ 1,942,587

See accompanying notes.

the little bank

STATEMENTS OF COMPREHENSIVE INCOME

Years Ended December 31, 2013 and 2012

	2013	2012
Net income	$ 2,788,059	$ 2,468,142
Other comprehensive income (loss):		
Unrealized (losses) gains on available for sale securities arising during the year	(2,071,277)	181,088
Tax related to unrealized gains	798,477	(69,809)
	(1,272,800)	111,279
Reclassification to realized gains	(59,042)	(80,485)
Tax related to realized gains	22,761	31,027
	(36,281)	(49,458)
Total	(1,309,081)	61,821
Total comprehensive income	$ 1,478,978	$ 2,529,963

See accompanying notes.

the little bank

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Years Ended December 31, 2013 and 2012

	Preferred stock Series A		Preferred stock Series B		Common stock		Retained earnings	Accumulated other comprehensive income (loss)	Total stockholders' equity
	Shares	Amount	Shares	Amount	Shares	Amount			
Balance at December 31, 2011	7,500	$ 7,301,605	375	$ 407,995	2,690,028	$ 24,395,291	$ 2,210,675	$ 670,346	$ 34,985,912
Net income	-	-	-	-	-	-	2,468,142	-	2,468,142
Other comprehensive income	-	-	-	-	-	-	-	61,821	61,821
Stock compensation expense	-	-	-	-	-	1,905	-	-	1,905
Preferred stock accretion (amortization)	-	160,182	-	(32,950)	-	-	(127,232)	-	-
Preferred stock repurchase and retirement	(4,700)	(4,700,000)	(374)	(374,000)	-	-	78,870	-	(4,995,130)
Common stock issued pursuant to 5% stock dividend	-	-	-	-	134,362	1,175,667	(1,175,667)	-	-
Cash paid for fractional shares	-	-	-	-	-	-	(1,220)	-	(1,220)
Cash dividends paid, $0.141 per common share	-	-	-	-	-	-	(397,442)	-	(397,442)
Cash dividends paid, 5.45% per annum	-	-	-	-	-	-	(398,323)	-	(398,323)
Balance at December 31, 2012	2,800	2,761,787	1	1,045	2,824,390	25,572,863	2,657,803	732,167	31,725,665
Net income	-	-	-	-	-	-	2,788,059	-	2,788,059
Other comprehensive loss	-	-	-	-	-	-	-	(1,309,081)	(1,309,081)
Stock compensation expense	-	-	-	-	-	15,281	-	-	15,281
Preferred stock accretion (amortization)	-	38,213	-	(45)	-	-	(38,168)	-	-
Preferred stock repurchase and retirement	(2,800)	(2,800,000)	(1)	(1,000)	-	-	-	-	(2,801,000)
Restricted stock awarded	-	-	-	-	35,050	141,225	-	-	141,225
Common stock retirement	-	-	-	-	(31,058)	(321,327)	-	-	(321,327)
Common stock issued pursuant to 5% stock dividend	-	-	-	-	141,566	1,698,792	(1,698,792)	-	-
Cash paid for fractional shares	-	-	-	-	-	-	(1,160)	-	(1,160)
Cash dividends paid, $0.146 per common share	-	-	-	-	-	-	(431,658)	-	(431,658)
Cash dividends paid, 5.45% per annum	-	-	-	-	-	-	(78,226)	-	(78,226)
Balance at December 31, 2013	-	$ -	-	$ -	2,969,948	$ 27,106,834	$ 3,197,858	$ (576,914)	$ 29,727,778

See accompanying notes.

the little bank

STATEMENTS OF CASH FLOWS

Years Ended December 31, 2013 and 2012

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 2,788,059	$ 2,468,142
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	564,639	626,705
(Recovery) provision for loan losses	(57,000)	815,000
Deferred income taxes	(82,342)	52,389
Gain on sale of investment securities	(59,042)	(80,485)
Impairment on real estate owned	150,183	31,100
Loss on sale of real estate owned	-	64,816
Loss on sale of bank premises and equipment	-	419
Stock compensation expense	156,506	1,905
Income from bank owned life insurance	(187,637)	(182,298)
Change in assets and liabilities:		
Decrease (increase) in accrued interest receivable	51,477	114,764
Decrease (increase) in other assets	534,040	455,959
(Decrease) increase in accrued interest payable	(22,826)	(50,462)
(Decrease) increase in accrued expenses and other liabilities	301,252	(90,111)
NET CASH PROVIDED BY OPERATING ACTIVITIES	4,137,309	4,227,843
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment in bank owned life insurance	(2,000,000)	-
Net change in certificates of deposit with banks	-	(2,205,000)
Redemptions of FHLB stock	259,400	298,200
Purchase of investment securities available for sale	(25,750,957)	(38,381,956)
Maturities and prepayments of investment securities available for sale	22,198,963	52,628,527
Proceeds from sales of investment securities available for sale	2,946,021	2,972,883
Net increase in loans	(8,400,851)	(14,721,909)
Proceeds from sales of other real estate owned	-	513,337
Purchases of bank premises and equipment	(257,639)	(1,262,029)
NET CASH USED BY INVESTING ACTIVITIES	(11,005,063)	(157,947)
CASH FLOWS FROM FINANCING ACTIVITIES		
Advances from the Federal Home Loan Bank	6,000,000	15,000,000
Repayments to the Federal Home Loan Bank	(9,500,000)	(16,500,000)
Net increase (decrease) in deposits	11,295,483	(1,625,616)
Repurchase and retirement of common stock	(321,327)	-
Redemption of perpetual preferred stock (Series A)	(2,800,000)	(4,621,130)
Redemption of perpetual preferred stock (Series B)	(1,000)	(374,000)
Cash dividends paid	(509,884)	(795,765)
Cash paid for fractional shares	(1,160)	(1,220)
NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES	4,162,112	(8,917,731)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(2,705,642)	(4,847,835)
CASH AND CASH EQUIVALENTS, BEGINNING	12,426,876	17,274,711
CASH AND CASH EQUIVALENTS, ENDING	$ 9,721,234	$ 12,426,876

See accompanying notes.

	2013	2012
SUPPLEMENTARY CASH FLOW INFORMATION		
Interest paid	$ 1,659,202	$ 2,179,581
Income taxes paid	$ 1,245,000	$ 1,463,000
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTMENT ACTIVITY		
Unrealized holding (losses) gains on available-for-sale securities, net	$ (1,309,081)	$ 61,821
Transfer of loans to real estate owned	$ 133,260	$ 228,000

See accompanying notes.

NOTE A - ORGANIZATION AND OPERATIONS

the little bank (the "Bank") was incorporated as a North Carolina chartered savings bank on September 16, 1998 and began operations on November 9, 1998. The Bank is headquartered in Kinston, North Carolina and has as its principal market area, Lenoir, Wayne, Onslow, Craven, Pitt and New Hanover Counties. The Bank operates under the laws of North Carolina and the rules and regulations of the Federal Deposit Insurance Corporation and the North Carolina Banking Commission. The Bank undergoes periodic examinations by those regulatory authorities.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for losses on loans and other real estate owned.

Cash Equivalents

For the purpose of presentation in the statement of cash flows, cash and cash equivalents include cash and due from banks, interest-earning deposits with banks and federal funds sold.

Certificates of Deposit with Banks

Certificates of deposits with banks currently have original maturities ranging from August 2014 through October 2016 and bear interest at rates ranging from 0.85% to 1.35%. None of the certificates of deposits had maturities of three months or less at the time of origination.

Investment Securities

Available-for-sale securities are reported at fair value and consist of bonds and notes not classified as trading securities nor as held-to-maturity securities. Unrealized holding gains and losses on available-for-sale securities are reported as a net amount in other comprehensive income, net of income taxes. Gains and losses on the sale of available-for-sale securities are recorded on the trade date and determined using the specific-identification method. Declines in the fair value of individual held-to-maturity and available-for-sale securities below their cost that are other than temporary would result in write-downs of the individual securities to their fair value. The full amount of the write down is recognized in earnings if the holder is unable to assert that they do not intend to sell the security prior to recovery and that it is more likely than not the holder will not be required to sell the impaired security prior to recovery. Otherwise, the credit loss portion of the impairment is recognized in earnings and the remaining impairment is recognized in other comprehensive income. Premiums and discounts are recognized in interest income using the interest method over the period to maturity.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity are reported at their outstanding principal balance adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment to the yield over the lives of the related loans.

A loan is considered impaired when, based on current information or events; it is probable that a borrower will be unable to pay all amounts due according to the contractual terms of the loan agreement. For loans determined to be impaired, the allowance is based on discounted cash flows using the loan's initial effective interest rate or the fair value of the collateral for certain collateral dependent loans. When the ultimate collectability of the impaired loan's principal is doubtful, all cash receipts are applied to principal. Once the recorded principal balance has been reduced to zero, future cash receipts are first recorded as recoveries of any amounts previously charged-off and are then applied to interest income, to the extent that any interest has been foregone.

Loans, including impaired loans, are generally classified as nonaccrual if they are past due as to maturity or payment of principal or interest for a period of more than 90 days, unless such loans are well-secured and in the process of collection. Loans that are current or past due less than 90 days may also be classified as nonaccrual if repayment in full of principal and/or interest is in doubt (as determined by the contractual terms of the note). Loans may be returned to accrual status when all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within an acceptable period of time, and there is a sustained period of repayment performance (generally a minimum of six months) by the borrower, in accordance with the contractual terms.

While a loan (including an impaired loan) is classified as nonaccrual and the future collectability of the recorded loan balance is doubtful, collections of interest and principal are generally applied as a reduction to the principal outstanding. When the future collectability of the recorded loan balance is not in doubt, interest income may be recognized on a cash basis. In the case where a nonaccrual loan had been partially charged-off, recognition of interest on a cash basis is limited to that which would have been recognized on the recorded loan balance at the contractual interest rate. Receipts in excess of that amount are recorded as recoveries to the allowance for loan losses until prior charge-offs have been fully recovered.

Allowance for Loan Losses

The provision for loan losses is based upon management's estimate of the amount needed to maintain the allowance for loan losses at an adequate level. In making the evaluation of the adequacy of the allowance for loan losses, management gives consideration to current and anticipated economic conditions, statutory examinations of the loan portfolio by regulatory agencies, delinquency information and management's internal review of the loan portfolio. Loans are considered impaired when it is probable that amounts due will not be collected in accordance with the contractual terms of the loan. The measurement of impaired loans is generally based on the present value of expected future cash flows discounted at the historical effective interest rate, or upon the fair value of the collateral if the loan is collateral dependent. If the recorded investment in the loan exceeds the measure of fair value, a valuation allowance is established as a component of the allowance for loan losses. While management uses the best information available to make evaluations, future adjustments to the allowance may be necessary if conditions differ substantially from the assumptions previously used in making the evaluations.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (Continued)

In addition, regulatory examiners may require the Bank to recognize changes to the allowance for loan losses based on their judgments about information available to them at the time of their examination. Historical loss calculations are based on a twelve quarter rolling average loss ratio calculation with the most recent year's loss history included in the model. The impact is to more quickly recognize and increase the loss history for the loan portfolio.

Bank Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets which are thirty or forty years for buildings and three to ten years for furniture and equipment. Leasehold improvements are amortized over the terms of the respective leases or the estimated useful lives of the improvements, whichever is shorter. Repairs and maintenance costs are charged to operations as incurred, and additions and improvements to premises and equipment are capitalized. Upon sale or retirement, the cost and related accumulated depreciation are removed from the accounts and any gains or losses are reflected in current operations.

Real Estate Owned

Real estate acquired through, or in lieu of, loan foreclosure is initially recorded at fair value, less estimated selling costs, at the date of foreclosure establishing a new cost basis. After foreclosure, valuations of the property are periodically performed by management and the real estate is carried at fair value minus estimated cost to sell the property. Revenue and expenses from operations and changes in the valuation allowance are charged to operations.

Federal Home Loan Bank Stock

As a requirement for membership, the Bank invests in stock of the Federal Home Loan Bank of Atlanta ("FHLB"). This investment is carried at cost. Due to the redemption provisions of the FHLB, the Bank estimated that fair value equals cost and that this investment was not impaired.

Income Taxes

Income tax expense is based on net income and generally differs from income taxes paid due to deferred income taxes and benefits arising from income and expenses being recognized in different periods for financial and income tax reporting. The Bank uses the asset and liability method to account for deferred income taxes. The objective of the asset and liability method is to establish deferred tax assets and liabilities for the temporary differences between the financial reporting basis and the income tax basis of the Bank's assets and liabilities at enacted rates expected to be in effect when such amounts are recovered or settled.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes (Continued)

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax assets are also recognized for operating loss carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which the temporary differences are expected to be recovered or settled. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Uncertainty in income taxes is accounted for in accordance with the Income Taxes topic of the FASB Accounting Standards Codification ("ASC"), which clarifies the accounting for the recognition and measurement of the benefits of individual tax positions in the financial statements. Tax positions must meet a recognition threshold of more-likely-than-not in order for the benefit of those tax positions to be recognized in the Bank's financial statements. The Bank has determined that it does not have any material unrecognized tax benefits or obligations as of December 31, 2013 and 2012. Interest and penalties related to income tax assessments, if any, are reflected in income taxes in the accompanying statement of operations. Fiscal years ending on or after December 31, 2010 remain subject to examination by federal and state tax authorities.

Stock Compensation Plans

The Bank recognizes the cost of employee services received in exchange for an award of equity instruments in the financial statements over the period the employee is required to perform the services in exchange for the award (presumptively the vesting period). The Bank measures the cost of employee services received in exchange for an award based on the grant-date fair value of the award. The excess tax benefits are reported as financing cash inflows, rather than as a reduction of taxes paid, which is included within operating cash flows.

Earnings Per Common Share

Basic net income per common share is computed by dividing net income available to common stockholders by the weighted average number of shares of common stock outstanding during each period. Diluted earnings per common share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Bank relate solely to outstanding stock options. Diluted earnings per common share is computed by dividing net income available to common stockholders by the weighted average number of common stock equivalents and other potentially dilutive securities using the treasury stock method.

On October 29, 2013, the Bank's Board of Directors declared a 5% stock dividend, which was distributed November 29, 2013 to stockholders of record on November 15, 2013. On November 15, 2012, the Bank's Board of Directors declared a 5% stock dividend, which was distributed December 7, 2012 to stockholders of record on November 26, 2012. All references to per share results and weighted average common shares outstanding have been adjusted to reflect the effects of these stock dividends.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Earnings Per Common Share (Continued)

The computation of basic and diluted earnings per common share is presented below:

	2013	2012
Basic Earnings per Common Share		
Net income	$ 2,788,059	$ 2,468,142
Preferred stock dividends	(78,226)	(398,323)
Accretion of discount, net	(38,168)	(127,232)
Net income available to common stockholders	$ 2,671,665	$ 1,942,587
Weighted-average common shares outstanding	2,970,814	2,965,610
Basic earnings per common share	$ 0.90	$ 0.66
Diluted Earnings per Common Share		
Net income available to common stockholders	$ 2,671,665	$ 1,942,587
Weighted-average common shares outstanding	2,970,814	2,965,610
Dilutive effect of stock options	4,927	-
Weighted-average common shares outstanding adjusted for effect of dilutive securities	2,975,741	2,965,610
Diluted earnings per common share	$ 0.90	$ 0.66

At December 31, 2013 and 2012, there were 105,005 and 62,582 options outstanding, respectively. At December 31, 2013 and 2012, there were 90,348 and 62,582 options outstanding, respectively, after adjusting for the 5% stock dividend during 2013, which were antidilutive since the exercise price exceeds the average market price for the year. These option shave been omitted from the calculations of the dilutive effect of stock options.

Comprehensive Income

The Bank reports as comprehensive income (loss) all changes in stockholders' equity during the year from sources other than stockholders. Other comprehensive income (loss) refers to all components (revenues, expenses, gains, and losses) of comprehensive income that are excluded from net income. The Bank's only component of other comprehensive income (loss) is unrealized gains and losses on investment securities available for sale, net of income taxes.

Recent Accounting Pronouncements

The following is a summary of recent authoritative pronouncements that could impact the accounting, reporting, and/or disclosure of financial information by the Bank.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements (Continued)

In February 2013, the FASB issued Accounting Standards Update ("ASU") 2013-02, "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." This guidance is the culmination of the FASB's deliberation on reporting reclassification adjustments from accumulated other comprehensive income ("AOCI"). The amendments in ASU 2013-02 do not change the current requirements for reporting net income or other comprehensive income. However, the amendments require disclosure of amounts reclassified out of AOCI in its entirety, by component, on the face of the statement of operations or in the notes thereto. Amounts that are not required to be reclassified in their entirety to net income must be cross-referenced to other disclosures that provide additional detail. This standard is effective for nonpublic entities prospectively for annual and interim reporting periods beginning after December 15, 2013.

In 2013, the FASB issued ASU 2014-04, Receivables (Topic 310), "Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure". The ASU clarifies that an in-substance repossession or foreclosure occurs upon either the creditor obtaining legal title to the residential real estate property or the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. The amendments are effective for annual periods beginning after December 15, 2014, and interim periods beginning after December 15, 2015. The amendments may be adopted using either a modified retrospective transition method or a prospective transition method. Early adoption is permitted. Management does not believe the amendments will have a material impact on the Bank's financial condition, results of operations, or cash flows.

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

From time to time, the FASB issues exposure drafts for proposed statements of financial accounting standards. Such exposure drafts are subject to comment from the public, to revisions by the FASB and to final issuance by the FASB as statements of financial accounting standards. Management considers the effect of the proposed statements on the financial statements of the Bank and monitors the status of changes to and proposed effective dates of exposure drafts.

Subsequent Events

In preparing these financial statements, the Bank has evaluated events and transactions for potential recognition or disclosure through April 9, 2014, the date the financial statements were available to be issued.

NOTE C - INVESTMENT SECURITIES

The following is a summary of the securities portfolios by major classification:

	December 31, 2013			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Securities available-for-sale:				
U.S. agency securities	$ 34,000,000	$ 2,929	$ (842,433)	$ 33,160,496
Mortgage-backed securities-Government-sponsored Enterprises ("GSE")	27,526,329	398,537	(276,960)	27,647,906
Municipal bonds	5,325,410	10,559	(231,467)	5,104,502
	$ 66,851,739	$ 412,025	$ (1,350,860)	$ 65,912,904

	December 31, 2012			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Securities available-for-sale:				
U.S. agency securities	$ 33,000,000	$ 99,893	$ (10,380)	$ 33,089,513
Mortgage-backed securities-GSE	29,550,128	986,966	-	30,537,094
Municipal bonds	3,873,597	120,395	(5,390)	3,988,602
	$ 66,423,725	$ 1,207,254	$ (15,770)	$ 67,615,209

The Bank sold available-for sale securities with a carrying value of $2.9 million during the year ended December 31, 2013. These sales resulted in gross gains on the sale of investments totaling approximately $59,000. For the year ended December 31, 2012, the Bank sold available-for sale securities with a carrying value of $2.9 million with a gross gains on the sale of investments totaling approximately $80,000.

The amortized cost and fair value of securities available-for-sale at December 31, 2013 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-sale	
	Amortized cost	Fair value
Due within one year	$ 2,835	$ 2,996
Due after one year through five years	32,668,416	31,877,645
Due after five years through ten years	4,311,965	4,291,149
Due after ten years	29,868,523	29,741,114
	$ 66,851,739	$ 65,912,904

NOTE C - INVESTMENT SECURITIES (Continued)

For the purposes of the maturity table, mortgage-backed securities, which are not due at a single maturity date, have been allocated over maturity groupings based on the weighted-average contractual maturities of underlying collateral. The mortgage-backed securities may mature earlier than their weighted-average contractual maturities because of principal payments.

Securities with a carrying value of $11,863,601 million at December 31, 2013 were pledged as collateral on public deposits.

The following tables show gross unrealized losses and fair values of investment securities, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position at December 31, 2013 and 2012. At December 31, 2013, the unrealized losses relate to thirty-one U.S. agency securities, fifteen mortgage-backed securities-GSE and eleven municipal bonds, all of which had continuous unrealized losses of less than twelve months plus two U.S. agency securities with continuous unrealized losses for twelve months or more. At December 31, 2012, the unrealized losses relate to three U.S. agency securities and one municipal bond, all of which had continuous unrealized losses of less than twelve months. The unrealized losses relate to debt securities that have incurred fair value reductions due to higher market interest rates since the securities were purchased. The unrealized losses are not likely to reverse unless and until market interest rates decline to the levels that existed when the securities were purchased. Since none of the unrealized losses relate to the marketability of the securities or the issuer's ability to honor redemption obligations, and considering that management has the intent and ability to hold these investments until recovery, none of the securities are deemed to be other than temporarily impaired. Should the Bank decide in the future to sell securities in an unrealized loss position, or determine that impairment of any securities is other than temporary, irrespective of a decision to sell, an impairment loss would be recognized in the period such determination is made.

NOTE C - INVESTMENT SECURITIES (Continued)

	December 31, 2013					
	Less Than 12 Months		12 Months or More		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
	(Amounts in thousands)					
Securities available for sale:						
U.S. agency securities	$ 30,261	$ 739	$ 1,896	$ 104	$ 32,157	$ 843
Mortgage-backed securities-GSE	12,674	277	-	-	12,674	277
Municipal bond	4,489	231	-	-	4,489	231
Total temporarily impaired securities	$ 47,424	$ 1,247	$ 1,896	$ 104	$ 49,320	$ 1,351

	December 31, 2012					
	Less Than 12 Months		12 Months or More		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
	(Amounts in thousands)					
Securities available for sale:						
U.S. agency securities	$ 2,990	$ 10	$ -	$ -	$ 2,990	$ 10
Municipal bond	450	6	-	-	450	6
Total temporarily impaired securities	$ 3,440	$ 16	$ -	$ -	$ 3,440	$ 16

NOTE D – LOANS

Following is a summary of loans at December 31:

	2013	2012
Residential mortgage real estate	$ 65,889,287	$ 52,306,213
Commercial real estate	75,861,856	69,648,752
Construction and land development	30,653,960	40,096,951
Commercial and industrial loans	31,075,127	30,520,173
Farmland and agriculture	4,624,631	4,151,449
Home equity loans	12,787,195	15,914,226
Consumer loans	1,937,813	2,090,557
Subtotal	222,829,869	214,728,321
Allowance for loan losses	(3,850,004)	(4,073,047)
Total	$ 218,979,865	$ 210,655,274

The loans presented above are net of deferred loan fees of $401,290 and $337,375 at December 31, 2013 and 2012, respectively.

The Bank has granted loans to certain directors and executive officers and their related interests. Such loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other borrowers and, in management's opinion, do not involve more than the normal risk of collectability. All loans to directors and executive officers or their interests are submitted to the Board of Directors for approval. A summary of loans to directors, executive officers and their related interests follows:

	2013	2012
Beginning balance	$ 2,848,811	$ 2,241,975
Disbursements during the year	3,381,635	3,278,876
Collections during the year	(4,413,597)	(2,672,040)
Ending balance	$ 1,816,849	$ 2,848,811

At December 31, 2013, the Bank had pre-approved but unused lines of credit totaling $2.2 million to executive officers, directors and their related interests.

Loans are primarily made in Eastern North Carolina, principally Lenoir, Wayne, Onslow, Craven, Pitt, and New Hanover Counties. Real estate loans can be affected by the condition of the local real estate market. Loans can be further affected by the local economic conditions.

NOTE D – LOANS (Continued)

The following describe the risk characteristics relevant to each of the portfolio segments.

Commercial and residential real estate
Commercial and residential real estate secured loans are subject to underwriting similar to real estate construction loans. These loans are either cash flow loans or development loans paid from the sale of underlying real estate. Commercial real estate lending typically involves higher risk and higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in real estate markets or the general economy. The properties securing the Bank's commercial real estate portfolio are principally secured by owner-occupied buildings including professional practices, office and church properties and single family rental properties. Management monitors and evaluates commercial real estate loans based on collateral, market area and risk grade criteria. Residential real estate properties are typically secured by the primary residence of the borrower and the combined loan-to-value ratio is usually 90% or less.

Construction and land development
Commercial and residential construction and land development loans are underwritten utilizing independent appraisal or evaluations, sensitivity analysis of absorption and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the project as completed. These estimates may be imprecise in some situations. Construction loans often involve the disbursement of funds with the repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans, sales of developed property or an interim loan commitment from the Bank until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, general economic conditions, availability of long-term financing and government regulation of real property.

Commercial and industrial
Non-real estate secured commercial and industrial loans are underwritten after evaluating and understanding the borrowers' ability to operate profitably and prudently expand its business. Underwriting standards are designed to promote relationship banking rather than transactional banking. Management examines current and projected cash flows of the borrower to determine the ability of the borrower to repay its obligations as agreed. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower and tertiary, as applicable, the guarantors. The cash flows of borrowers, however, may not materialize as expected and the collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed or other business assets such as accounts receivable, inventory or equipment and usually incorporate a personal guaranty.

Farmland and agricultural
Farm and agricultural lending primarily consists of crop loans and some land loans. Management examines current and projected cash flows of the borrower to determine the ability of the borrower to repay its obligations as agreed. Farm and agricultural loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower and tertiary, as applicable, the guarantors. Generally, the Bank underwrites crop loans on a single crop season in order to minimize risk of unforeseen losses in the collateral due to acts of nature.

NOTE D – LOANS (Continued)

Consumer
Consumer loans primarily consist of home equity lines of credit. Home equity lines of credit are primarily underwritten based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not materialize as expected and the collateral securing these loans may fluctuate in value. The combined loan value on these loans generally does not exceed 90%.

The Bank maintains an independent loan review function that reviews and validates our credit risk portfolio on a periodic basis. Results of these reviews are presented to management and the board of directors. The loan review process complements and reinforces the risk identification and assessment decisions made by bankers and credit personnel, as well as the Bank's policies and procedures.

Nonperforming assets and potential problem loans

Due to economic and legal reasons related to the deterioration of an individual borrower's financial condition, the Bank may grant concessions on a loan-by-loan basis. In situations where a borrower's financial condition has deteriorated but they continue to be creditworthy customers who have a willingness and capacity to repay their debts, the Bank may find it mutually beneficial to work constructively with borrowers in order to protect the Bank's investment as much as possible. The Bank may offer a variety of troubled debt restructuring programs including, but not limited to, a modification of the loan terms such as a reduction of the contractual interest rate, principal, payment amount or accrued interest; an extension of the maturity date at a stated interest rate lower than the current market rate for a new debt with similar risk; and a change in payment type, e.g. from principal and interest to interest only with all principal and interest due at maturity.

On a loan-by-loan basis, the Bank restructures loans that were either on nonaccrual basis prior to restructuring or on accrual basis prior to restructuring. If a loan was on nonaccrual basis prior to restructuring, it remains on nonaccrual basis until the borrower has demonstrated a willingness and ability to meet the terms and conditions of the restructuring and to make the restructured loan payments, generally for a period of at least six months. The Bank has not immediately placed any restructured loan on accrual status that was on nonaccrual status prior to restructuring.

If a restructured loan was on accrual basis prior to restructuring and the Bank expects the borrower to perform to the terms and conditions of the loan after restructuring, the loan remains on an accrual basis and placement on nonaccrual is not required.

NOTE D – LOANS (Continued)

For the twelve months ended December 31, 2013 and 2012, the following table represents a breakdown of the types of concessions made by loan class.

2013	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Interest rate concession			
Construction & land development	1	$ 13,388	$ 13,388

2012	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Extended payment terms			
Construction & land development	1	$ 450,611	$ 450,611

Of the loans modified as troubled debt restructurings within the previous twelve months, there were no loans that were ninety or more days past due and therefore had a payment default as of December 31, 2013 and 2012.

Troubled debt restructured loans are included within impaired loans. The Bank is not committed to advance additional funds on restructured loans.

NOTE D – LOANS (Continued)

The ending balances of loans and the related allowance presented by portfolio class and allowance methodology as of December 31 are as follows:

2013	Residential Real Estate	Commercial Real Estate	Construction & Land Development	Commercial & Industrial	Farmland & Agriculture	Home Equity Loans	Consumer	Total
Allowance for credit losses								
Beginning balance	$ 1,316,316	$ 578,005	$ 1,144,781	$ 847,126	$ 65,738	$ 77,417	$ 43,664	$ 4,073,047
Charge-offs	(49,789)	(176,953)	-	-	-	(162,792)	(34,315)	(423,849)
Recoveries	61,645	-	85,178	5,109	-	-	105,874	257,806
Provision (Recovery)	347,823	562,858	(713,624)	(334,824)	(23,621)	170,076	(65,688)	(57,000)
Ending balance	$ 1,675,995	$ 963,910	$ 516,335	$ 517,411	$ 42,117	$ 84,701	$ 49,535	$ 3,850,004
Ending balance: individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Ending balance: collectively evaluated for impairment	1,675,995	963,910	516,335	517,411	42,117	84,701	49,535	3,850,004
Financing receivables:								
Ending balance	$ 65,889,287	$ 75,861,856	$ 30,653,960	$ 31,075,127	$ 4,624,631	$ 12,787,195	$ 1,937,813	$ 222,829,869
Ending balance: individually evaluated for impairment	723,048	484,009	152,428	-	-	-	5,544	1,365,029
Ending balance: collectively evaluated for impairment	$ 65,166,239	$ 75,377,847	$ 30,501,532	$ 31,075,127	$ 4,624,631	$ 12,787,195	$ 1,932,269	$ 221,464,840

NOTE D – LOANS (Continued)

2012	Residential Real Estate	Commercial Real Estate	Construction & Land Development	Commercial & Industrial	Farmland & Agriculture	Home Equity Loans	Consumer	Total
Allowance for credit losses								
Beginning balance	$ 1,495,402	$ 612,984	$ 1,227,121	$ 389,826	$ 21,500	$ 113,478	$ 37,265	$ 3,897,576
Charge-offs	(264,302)	(7,855)	(200,000)	(5,090)	-	(71,062)	(142,596)	(690,905)
Recoveries	22,780	-	2,172	17,953	-	-	8,471	51,376
Provision	62,436	(27,124)	115,488	444,437	44,238	35,001	140,524	815,000
Ending balance	$ 1,316,316	$ 578,005	$ 1,144,781	$ 847,126	$ 65,738	$ 77,417	$ 43,664	$ 4,073,047
Ending balance: individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Ending balance: collectively evaluated for impairment	1,316,316	578,005	1,144,781	847,126	65,738	77,417	43,664	4,073,047
Financing receivables:								
Ending balance	$ 52,306,213	$ 69,648,752	$ 40,096,951	$ 30,520,173	$ 4,151,449	$ 15,914,226	$ 2,090,557	$ 214,728,321
Ending balance: individually evaluated for impairment	757,988	692,044	900,513	-	-	-	45,595	2,396,140
Ending balance: collectively evaluated for impairment	$ 51,548,225	$ 68,956,708	$ 39,196,438	$ 30,520,173	$ 4,151,449	$ 15,914,226	$ 2,044,962	$ 212,332,181

NOTE D – LOANS (Continued)

Credit Risk Profile by Internally Assigned Grade

Loans are monitored for credit quality on a monthly basis to monitor past due status and the composition of the loans outstanding at December 31 by credit quality indicator is provided below. The credit quality indicators used are dependent on the portfolio class to which the loan relates.

Loan credit quality indicators for all loans within the portfolio are developed through review of individual borrowers on an ongoing basis. The indicators represent the rating for loans as of the date presented based on the most recent assessment performed. These credit quality indicators are defined below.

	Residential Real Estate	Commercial Real Estate	Construction & Land Development	Commercial & Industrial	Farmland & Agriculture	Home Equity Loans	Consumer	Total
2013								
Grade:								
Excellent Credit	$ -	$ -	$ -	$ 760,716	$ -	$ -	$ 68,352	$ 829,068
Good Quality	2,323,987	11,635	326,491	13,075,115	-	2,321,879	269,289	18,328,396
Satisfactory	43,997,083	49,726,002	22,097,840	12,375,976	2,565,985	8,074,260	762,016	139,599,162
Low Satisfactory	17,974,406	21,535,989	7,862,024	3,253,943	1,656,146	2,391,056	354,209	55,027,773
Special Mention	977,412	3,715,678	304,228	1,450,180	-	-	13,819	6,461,317
Substandard	556,573	904,016	152,428	-	-	-	-	1,613,017
Doubtful	-	-	-	-	-	-	-	-
Loss	-	-	-	-	-	-	-	-
Ungraded	118,922	200,958	-	176,625	402,500	-	473,421	1,372,426
Total	$ 65,948,383	$ 76,094,278	$ 30,743,011	$ 31,092,555	$ 4,624,631	$ 12,787,195	$ 1,941,106	223,231,159
Deferred Fees								(401,290)
TOTAL								$ 222,829,869

NOTE D – LOANS (Continued)

Credit Risk Profile by Internally Assigned Grade (Continued)

	Residential Real Estate	Commercial Real Estate	Construction & Land Development	Commercial & Industrial	Farmland & Agriculture	Home Equity Loans	Consumer	Total
2012								
Grade:								
Excellent Credit	$ -	$ -	$ -	$ 777,826	$ -	$ -	$ 95,373	$ 873,199
Good Quality	1,277,652	21,530	481,539	11,688,175	-	2,990,673	341,598	16,801,167
Satisfactory	31,976,005	42,025,773	24,033,776	12,685,951	1,500,404	9,587,578	723,277	122,532,764
Low Satisfactory	16,433,992	21,750,846	13,104,492	3,846,967	2,651,045	3,170,508	344,037	61,301,887
Special Mention	2,193,909	5,357,413	739,651	1,551,103	-	165,356	34,582	10,042,014
Substandard	450,762	692,044	900,513	-	-	-	-	2,043,319
Doubtful	-	-	-	-	-	-	-	-
Loss	-	-	-	-	-	-	-	-
Ungraded	149	410	915,415	-	-	110	555,262	1,471,346
Total	$ 52,332,469	$ 69,848,016	$ 40,175,386	$ 30,550,022	$ 4,151,449	$ 15,914,225	$ 2,094,129	215,065,696
Deferred Fees								(337,375)
TOTAL								$ 214,728,321

NOTE D – LOANS (Continued)

Risk Grade Definitions

Excellent Credit
Credits in this category are virtually risk-free and are well-collateralized by cash-equivalent instruments. The repayment program is well-defined and achievable, repayment sources are numerous, and no material documentation deficiencies exist.

Good Quality
Credits in this category are to applicants that meet or exceed the Bank's guidelines, have a definite repayment agreement in effect, and are being repaid as agreed. A borrower in this category may have one or more of the following characteristics: performance and financial condition compares favorably to industry standards and in accordance with loan covenants, proven cash flows that consistently cover the debt service requirements, industry conditions are more positive than negative and the borrower's position is strong relative to peers, and alternative funding sources are available.

Satisfactory
Credits in this category are to an applicant who has four or fewer minor exceptions to the Bank's guidelines. No major exceptions are present. The credit is fundamentally sound, and risk factors are reasonable and acceptable. The financial condition of the borrower and/or guarantor(s) is satisfactory. The credits are in conformance with existing Credit Policy, have only minor deviation from established guidelines, and the loss potential is considered low. Other characteristics could include one or more of the following: cash flow and/or balance sheet liquidity provides repayment capacity, the current appraisal of collateral provides adequate margin for loan/lease extension, and there are no material documentation deficiencies.

Low Satisfactory
General characteristics are similar to a Satisfactory risk grade, except there may be a major exception to the guidelines that is clearly mitigated by other economic factors; or several minor exceptions are noted that are clearly mitigated by other economic factors.

Special Mention
Special mention loans include loans with one or more of the following characteristics:

- Loans with one or more major exceptions with no mitigating factors.
- Extending loans that are currently performing satisfactorily but with potential weaknesses that may, if not corrected, weaken the asset or inadequately protect the Bank's position at some future date.
- Loans where the borrower's ability to repay from primary (intended) repayment sources is not clearly sufficient to ensure performance as contracted. However, the loan is performing as contracted, secondary repayment sources are clearly sufficient to protect against the risk of loss, and the Bank can reasonably expect that the circumstances causing the repayment concern will be resolved.
- Access to alternate financing sources exists, but may be limited to institutions specializing in higher risk financing.
- Loans where adverse economic conditions that develop subsequent to the loan origination that don't jeopardize liquidation of the debt but do increase the level of risk.
- Credits which have been formally criticized by a regulatory agency, internal bank loan review, or the lending officer operating under the current policy regarding risk grading.
- Assets in this category are currently protected by primary and secondary repayment sources, but are potentially weak. These assets constitute an undue and unwarranted credit risk, but not to the point of justifying a classification of Substandard.

NOTE D – LOANS (Continued)

Risk Grade Definitions (Continued)

Substandard
A substandard loan is inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt; they are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful
Loans classified as doubtful have all the weaknesses inherent in loans classified substandard, plus the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions, and values highly questionable and improbable. However, these loans are not yet rated as loss because certain events may occur which would salvage the debt.

Loss
Loans classified as loss are considered uncollectable and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this potentially worthless loan even though partial recovery may be affected in the future. Loans may reside in this classification for administrative purposes for a period not to exceed the earlier of thirty (30) days or calendar quarter-end.

Ungraded
Credits in this category include credits in the loan and appraisal fee work-in-process accounts and overdraft plan accounts which are not risk graded.

Age Analysis of Past Due Financing Receivables

The aging of the outstanding loans by class at December 31 is provided in the table below. The calculation of days past due begins on the day after payment is due and includes all days through which all required interest or principal have not been paid. Loans less than 30 days past due are considered current due to certain grace periods that allow borrowers to make payments within a stated period after the due date and still remain in compliance with the loan agreement.

2013	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing
Residential real estate	$ 168,315	$ 286,507	$ 239,334	$ 694,156	$ 65,195,131	$ 65,889,287	$ -
Commercial real estate	-	-	-	-	75,861,856	75,861,856	-
Construction and land development	-	-	-	-	30,653,960	30,653,960	-
Commercial and industrial	-	-	-	-	31,075,127	31,075,127	-
Farmland and agriculture	-	-	-	-	4,624,631	4,624,631	-
Home equity loans	-	-	-	-	12,787,195	12,787,195	-
Consumer loans	3,692	420	-	4,112	1,933,701	1,937,813	-
Total	$ 172,007	$ 286,927	$ 239,334	$ 698,268	$ 222,131,601	$ 222,829,869	$ -

NOTE D – LOANS (Continued)

Age Analysis of Past Due Financing Receivables (Continued)

2012	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing
Residential real estate	$ 175,575	$ -	$ -	$ 175,575	$ 52,130,638	$ 52,306,213	$ -
Commercial real estate	666,203	-	182,039	848,242	68,800,510	69,648,752	-
Construction and land development	-	-	-	-	40,096,951	40,096,951	-
Commercial and industrial	26,404	-	-	26,404	30,493,769	30,520,173	-
Farmland and agriculture	-	-	-	-	4,151,449	4,151,449	-
Home equity loans	9,966	-	-	9,966	15,904,260	15,914,226	-
Consumer loans	-	-	35,547	35,547	2,055,010	2,090,557	35,547
Total	$ 878,148	$ -	$ 217,586	$ 1,095,734	$ 213,632,587	$ 214,728,321	$ 35,547

Impaired Loans

The following table provides information on impaired loans at December 31, including interest income recognized in the period during which the loans and leases were considered impaired. The recorded investment balance includes the loan balance, accrued interest, and deferred fees. At December 31, 2013 and 2012, there were no impaired loans with an allowance recorded.

2013	Recorded Investment	Legal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Residential real estate	$ 727,089	$ 755,616	$ -	$ 767,859	$ 32,135
Commercial real estate	485,562	568,063	-	519,656	14,225
Construction and land development	152,428	152,428	-	177,188	-
Consumer loans	5,545	5,544	-	7,643	423
Total:					
Residential real estate	$ 727,089	$ 755,616	$ -	$ 767,859	$ 32,135
Commercial real estate	485,562	568,063	-	519,656	14,225
Construction and land development	152,428	152,428	-	177,188	-
Commercial and industrial	-	-	-	-	-
Farmland and agriculture	-	-	-	-	-
Home equity loans	-	-	-	-	-
Consumer loans	5,545	5,544	-	7,643	423
Total	$ 1,370,624	$ 1,481,651	$ -	$ 1,472,346	$ 46,783

NOTE D – LOANS (Continued)

Impaired Loans (Continued)

2012	Recorded Investment	Legal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Residential real estate	$ 761,342	$ 757,988	$ -	$ 777,408	$ 38,059
Commercial real estate	692,717	692,044	-	725,936	10,790
Construction and land development	900,513	1,050,513	-	1,081,212	-
Consumer loans	47,383	45,595	-	49,003	528
Total:					
Residential real estate	$ 761,342	$ 757,988	$ -	$ 777,408	$ 38,059
Commercial real estate	692,717	692,044	-	725,936	10,790
Construction and land development	900,513	1,050,513	-	1,081,212	-
Commercial and industrial	-	-	-	-	-
Farmland and agriculture	-	-	-	-	-
Home equity loans	-	-	-	-	-
Consumer loans	47,383	45,595	-	49,003	528
Total	$ 2,401,955	$ 2,546,140	$ -	$ 2,633,559	$ 49,377

Loans on Nonaccrual Status

The recorded investment, by class, in loans on nonaccrual status at December 31 is as follows:

	2013	2012
Commercial real estate	$ 203,512	$ 404,044
Construction and land development	152,428	900,513
Residential real estate	239,334	-
Total	$ 595,274	$ 1,304,557

NOTE D – LOANS (Continued)

Impaired Loans (Continued)

Non-accrual loans are all considered impaired. The interest income that has not been recorded due to the loans being in nonaccrual status for 2013 and 2012 was approximately $7,000 and $19,000, respectively.

NOTE E - BANK PREMISES AND EQUIPMENT

Following is a summary of bank premises and equipment at December 31, 2013 and 2012:

	2013	2012
Land	$ 516,000	$ 516,000
Buildings	2,521,215	2,521,215
Leasehold improvements	754,784	741,097
Furniture and equipment	2,205,628	2,021,051
Construction in process	53,902	-
	6,051,529	5,799,363
Accumulated depreciation	(2,587,076)	(2,264,911)
Total	$ 3,464,453	$ 3,534,452

Depreciation amounting to approximately $328,000 and $278,000 for the years ended December 31, 2013 and 2012, respectively, is included in occupancy and equipment expense.

The Bank leases a branch facility in Kinston under a noncancelable operating lease with a related party. The lease is for a five-year term expiring October 31, 2018. It also provides the Bank the right to renew for an additional five-year term at the expiration of the current term. The Bank also leases a branch facility in LaGrange under a noncancelable operating lease with the same director. The lease is for a five-year term expiring June 30, 2017. The lease includes an option to renew for an additional five-year term at the expiration of the current term.

The Bank leases branch facilities in Jacksonville and Goldsboro under noncancelable operating leases with unrelated parties. These leases range from five to ten-year terms with the Jacksonville lease expiring November 1, 2017 and the Goldsboro lease expiring March 31, 2015. Annual rental payments are $32,892 and $33,599, respectively. Each lease includes an option to renew for multiple terms at the expiration of the initial term.

The Bank has an operating land lease in New Bern for the location of a full-service branch with an unrelated party. The initial twenty year lease term expires December 31, 2031. The lease includes two ten-year renewal options. Annual lease payments are $45,000.

In October 2013, the Bank entered into a noncancelable operating lease in Wilmington with an unrelated party for a loan production office. The initial three-year lease term expires September 30, 2016. The lease includes two, one-year renewal options. Annual lease payments are $27,788.

NOTE E - BANK PREMISES AND EQUIPMENT (Continued)

A summary of the minimum future rental payments under the leases described above is as follows at December 31, 2013:

Period	Amount
2014	$ 197,773
2015	172,575
2016	157,228
2017	124,386
2018	82,881
Thereafter	655,000
	$ 1,389,843

Total rent expense under operating leases was approximately $173,000 and $176,000 for the years ended December 31, 2013 and 2012, respectively, and is included in occupancy and equipment expense.

NOTE F – DEPOSITS

Deposits consist of the following:

	2013	2012
Demand	$ 86,377,584	$ 72,653,968
Savings	3,350,301	3,411,736
Money market and NOW	44,789,115	41,508,860
Time	126,876,367	132,523,320
Total	$ 261,393,367	$ 250,097,884

Time deposits in denominations of $100,000 or more were $68.5 million and $69.3 million at December 31, 2013 and 2012, respectively. Interest expense on such deposits aggregated $0.7 million in 2013 and $0.9 million in 2012.

At December 31, 2013, the scheduled maturities of certificates of deposit are as follows:

	Less than $100,000	$100,000 or more	Total
2014	$ 45,486,758	$ 45,869,189	$ 91,355,947
2015	9,437,655	17,875,612	27,313,267
2016	1,913,208	2,507,102	4,420,310
2017	922,094	922,699	1,844,793
2018	623,518	1,318,532	1,942,050
Total	$ 58,383,233	$ 68,493,134	$ 126,876,367

NOTE G - ADVANCES FROM FEDERAL HOME LOAN BANK

The Bank has available a line of credit totaling $78.0 million, representing 25% of total assets, with the Federal Home Loan Bank of Atlanta ("FHLB"). At December 31, 2013, advances under this line amounted to $20.0 million, with interest rates ranging from .34% to 2.58%. At December 31, 2012, advances under this line amounted to $23.5 million, with interest rates ranging from 0.31% to 2.58%.

At December 31, 2013, the scheduled maturities of Federal Home Loan Bank Advances are as follows:

	Maturity	Interest Rate	Amount
Short Term			
Fixed	2014	0.340% to 1.480%	$ 8,500,000
Daily	2014	0.355%	2,000,000
Short Term			10,500,000
Long Term			
Fixed	2015	0.410% to 1.920%	4,000,000
Fixed	2016	0.790% to 2.340%	5,000,000
Fixed	2017	2.580%	500,000
Long Term			9,500,000
			$ 20,000,000

The FHLB advances are not callable by the FHLB. The Bank's advances with the FHLB are secured by its qualifying first residential and commercial real estate loans with principal balances of $50.1 million at December 31, 2013. At December 31, 2013, the line of credit with the FHLB was not secured by any pledged investment securities.

The Bank also has two available lines of credit, for $6.0 million and $10.0 million from its correspondent banks as of December 31, 2013. As of December 31, 2012, the Bank had two available lines of credit for $6.0 million and $10.0 million from its correspondent banks.

NOTE H – NON-CUMULATIVE PERPETUAL PREFERRED STOCK

On December 23, 2008, the Bank issued 7,500 shares of non-cumulative perpetual preferred stock ("Series A"), to the U.S. Treasury for $7,500,000. Additionally, the Bank issued 375 preferred stock warrants to the U.S. Treasury as a condition to its participation in the Capital Purchase Program ("CPP"). The warrants were exercised immediately upon the issuance of the Series A preferred stock, which resulted in the issuance of 375 shares of non-cumulative perpetual preferred stock ("Series B"). Proceeds from this sale of preferred stock were used for general corporate purposes, including supporting the continued, anticipated growth of the Bank. Both the Series A and Series B preferred stock is non-voting, other than having class voting rights on certain matters. Series A pays dividends quarterly at a rate of 5% per annum and Series B pays dividends quarterly at a rate of 9% per annum.

The Series B preferred shares had an initial fair value of $452,397 using a discount rate of 14%. As a result, $77,397 was recorded as a premium on the Series B preferred stock and was being amortized as an increase in net income available to common stockholders over the expected five year period. Correspondingly, a discount of approximately $452,397 was recorded on the Series A preferred stock and was being accreted over the expected five year period.

NOTE H – NON-CUMULATIVE PERPETUAL PREFERRED STOCK (Continued)

On October 23, 2012, the U.S. Treasury completed the sale of the Series A and Series B preferred stock to private investors through a registered public offering. The Bank repurchased and retired 4,700 shares, or $4,700,000, of Series A preferred stock and 374 shares, or $374,000, of Series B preferred stock for $5,042,378, including payments of dividends of $56,738. The remaining $2,801,000 preferred stock was acquired by third-party investors.

On June 5, 2013, the Bank repurchased and retired the remaining $2,801,000 preferred stock held by third-party investors. The Bank repurchased and retired 2,800 shares, or $2,800,000, of Series A preferred stock and 1 share, or $1,000, of Series B preferred stock, all at par value. All transactions involving the repayment of preferred stock had been previously approved by the Bank's regulators.

NOTE I - INCOME TAXES

The significant components of the provision for income taxes for the years ended December 31, 2013 and 2012 are as follows:

	2013	2012
Current tax provision		
Federal	$ 1,251,440	$ 1,125,026
State	224,902	173,585
	1,476,342	1,298,611
Deferred tax expense		
Federal	(53,667)	64,286
State	9,435	2,971
	(44,232)	67,257
Provision for income tax expense before adjustment for deferred tax asset valuation allowance	1,432,110	1,365,868
Decrease in valuation allowance	(38,110)	(14,868)
Provision for income taxes	$ 1,394,000	$ 1,351,000

The difference between the provisions for income taxes and the amounts determined by applying the statutory federal income tax rate of 34% to income before income taxes is summarized below:

	2013	2012
Expense computed at statutory rate of 34%	$ 1,421,900	$ 1,298,508
Effect of state income taxes	154,663	116,527
Bank-owned life insurance	(63,796)	(61,981)
Tax exempt securities	(40,980)	(34,312)
Stock based compensation expense	-	648
Decrease to deferred tax asset valuation allowance	(38,110)	(14,868)
Other	(39,677)	46,478
	$ 1,394,000	$ 1,351,000

NOTE I - INCOME TAXES (Continued)

Significant components of deferred taxes at December 31, 2013 and 2012 are as follows:

	2013	2012
Deferred tax assets:		
Allowance for loan losses	$ 1,155,501	$ 1,255,046
Non-accrual interest	36,875	20,225
Real estate owned	57,010	-
Restricted stock	27,797	-
Non-qualified stock options	5,801	-
Prepaid expenses	31,804	245
Unrealized losses on available for sale securities	361,921	-
Other than temporary impairment	20,335	58,445
Total deferred tax assets	1,697,044	1,333,961
Less valuation allowance	(20,299)	(58,409)
Net deferred tax asset	1,676,745	1,275,552
Deferred tax liabilities:		
Premises and equipment	(46,689)	(89,759)
Unrealized gains on available for sale securities	-	(459,317)
Total deferred tax liabilities	(46,689)	(549,076)
Net recorded deferred tax asset	$ 1,630,056	$ 726,476

It is management's opinion that realization of the net deferred tax asset is more likely than not based on the Bank's history of taxable income and estimates of future taxable income. The valuation allowance of $20,299 relates to a $200,000 capital loss carryover which arose in 2008.

NOTE J - REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by federal and state banking agencies. 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 Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios, as prescribed by regulations, of total and Tier I capital to risk-weighted assets and of Tier I capital to average assets. Management believes, as of December 31, 2013 and 2012, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2013, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum amounts and ratios, as set forth in the table below. There are no conditions or events since that notification that management believes have changed the Bank's category.

NOTE J - REGULATORY MATTERS (Continued)

A summary of the Bank's actual capital components, those required for capital adequacy and those to be considered well capitalized under prompt corrective action provisions at December 31, 2013 and 2012, follows:

	Actual		Minimum for capital adequacy purposes		Minimum to be well capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in thousands)			
As of December 31, 2013:						
Total Capital (to Risk-Weighted Assets)	$ 33,222	14.29%	$ 18,597	8.0%	$ 23,247	10.0%
Tier I Capital (to Risk-Weighted Assets)	30,305	13.04%	9,299	4.0%	13,948	6.0%
Tier I Capital (to Average Assets)	30,305	9.71%	12,485	4.0%	15,606	5.0%
As of December 31, 2012:						
Total Capital (to Risk-Weighted Assets)	$ 33,885	14.73%	$ 18,408	8.0%	$ 23,011	10.0%
Tier I Capital (to Risk-Weighted Assets)	30,994	13.47%	9,204	4.0%	13,806	6.0%
Tier I Capital (to Average Assets)	30,994	10.11%	12,260	4.0%	15,326	5.0%

NOTE K - OFF-BALANCE SHEET RISK

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank, upon extension of credit is based on management's credit evaluation of the borrower. Collateral obtained varies but may include real estate, stocks, bonds, and certificates of deposit.

A summary of the contract amount of the Bank's exposure to off-balance sheet risk as of December 31, 2013 is as follows:

Financial instruments whose contract amounts represent credit risk:	
Commitments to extend credit	$ 8.8 million
Undisbursed lines of credit	29.4 million
Undisbursed construction loans	5.6 million
Letters of credit	0.1 million

NOTE L - CONCENTRATIONS OF CREDIT

All of the Bank's loans and commitments to extend credit and commercial and standby letters of credit have been granted to customers in the Bank's market area. Substantially all such customers are depositors of the Bank. The concentrations by type of loan are set forth in Note D. The Bank, as a matter of policy, does not extend credit to any single borrower or group of related borrowers in excess of the regulatory loan-to-one-borrower limit.

NOTE M - DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS

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

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and Due from Banks, Interest-Earning Deposits with Banks and Federal Funds Sold

The carrying amounts for cash and due from banks, interest-earning deposits with banks and federal funds sold approximate fair value because of the short maturities of those instruments.

Certificates of Deposit with Banks

The fair value of certificates of deposit with other banks is estimated based on discounting cash flows using the rates currently offered for instruments of similar remaining maturities.

Investment Securities

Fair value for investment securities equals quoted market price if such information is available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Loans

For certain homogenous categories of loans, such as residential mortgages, fair value is estimated using the quoted market prices for securities backed by similar loans, adjusted for differences in loan characteristics. The fair value of other types of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. There is no liquidity adjustment factor, which is deemed to be immaterial given the performance of the loan portfolio, used in the calculation of fair value.

NOTE M - DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

Accrued Interest

The carrying amount of accrued interest receivable is considered to approximate fair value.

Stock in Federal Home Loan Bank of Atlanta

The carrying value of the Federal Home Loan Bank stock approximates fair value based on the redemption provisions of the Federal Home Loan Bank.

Bank-Owned Life Insurance

The carrying value of life insurance approximates fair value because this investment is carried at cash surrender value, as determined by the insurer.

Deposits

The fair value of demand, savings, money market and NOW accounts is the amount payable on demand at the reporting date. The fair value of time deposits is estimated by discounting expected cash flows using the rates currently offered for instruments of similar remaining maturities.

Advances from Federal Home Loan Bank

The fair value of these advances is based upon the discounted present value of expected cash flows using current rates at which borrowings of similar maturity could be obtained.

Financial Instruments with Off-Balance Sheet Risk

With regard to financial instruments with off-balance sheet risk discussed in Note K it is not practicable to estimate the fair value of future financing commitments. The fair value of such commitments is insignificant because the underlying committed interest rates approximate market rates.

NOTE M - DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

The carrying amounts and estimated fair values of the Bank's financial instruments, none of which are held for trading purposes, are as follows at December 31, 2013 and 2012:

	2013		2012	
	Carrying value	Estimated fair value	Carrying value	Estimated fair value
	(Dollars in thousands)			
Financial assets:				
Cash and due from banks	$ 5,897	$ 5,897	$ 6,266	$ 6,266
Interest-earning deposits with banks	3,357	3,357	4,935	4,935
Federal funds sold	467	467	1,225	1,225
Certificates of deposit with banks	2,205	2,205	2,205	2,205
Investment securities available for sale	65,913	65,913	67,615	67,615
Loans	218,980	219,893	210,655	212,505
Accrued interest receivable	815	815	867	867
Stock in the Federal Home Loan Bank of Atlanta	1,267	1,267	1,527	1,527
Bank-owned life insurance	7,216	7,216	5,029	5,029
Financial liabilities:				
Deposits	261,393	253,671	250,098	250,226
Advances from the Federal Home Loan Bank	20,000	20,146	23,500	23,739
Accrued interest payable	85	85	108	108

NOTE N – FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

The fair value is determined through valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement costs). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting

NOTE N – FAIR VALUE MEASUREMENTS (continued)

entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, the accounting guidance establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Fair Value Hierarchy

The Bank groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3: Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

The Bank utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures.

Recurring Basis Measurements

The following tables set forth by level within the fair value hierarchy the Bank's assets and liabilities accounted for at fair value on a recurring basis as of December 31, 2013 and 2012. Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Bank's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

NOTE N – FAIR VALUE MEASUREMENTS (Continued)

Fair values of assets and liabilities measured on a recurring basis are as follows:

		Fair Value Measurements at December 31		
Description	Fair Value	(Level 1)	(Level 2)	(Level 3)
2013				
Investment securities available for sale				
U.S. agency securities	$ 33,160,496	$ -	$ 33,160,496	$ -
Mortgage-backed securities-GSE	27,647,906	-	27,647,906	-
Municipal bonds	5,104,502	-	5,104,502	-
	$ 65,912,904	$ -	$ 65,912,904	$ -
2012				
Investment securities available for sale				
U.S. agency securities	$ 33,089,513	$ -	$ 33,089,513	$ -
Mortgage-backed securities-GSE	30,537,094	-	30,537,094	-
Municipal bonds	3,988,602	-	3,988,602	-
	$ 67,615,209	$ -	$ 67,615,209	$ -

There were realized gross gains of $59,042 and no realized losses included in earnings for the sale of securities in 2013. There were realized gross gains of $80,485 and no realized losses included in earnings for the sale of securities in 2012. There were no unrealized gains or losses included in earnings during 2013 and 2012.

The valuation methodologies used for assets and liabilities recorded at fair value on a recurring basis are as follows:

Investment Securities Available for Sale
Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted and money prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 2 securities include governmental-sponsored enterprise securities, mortgage-backed securities, and municipal bonds.

There were no changes during the years ended December 31, 2013 and 2012 to the Bank's valuation techniques used to measure asset fair values on a recurring basis.

Non-Recurring Basis Measurements
Certain other financial assets are measured at fair value on a nonrecurring basis, that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

NOTE N – FAIR VALUE MEASUREMENTS (Continued)

Fair values of assets and liabilities measured on a nonrecurring basis at December 31, 2013 and 2012 are as follows:

		Fair Value Measurements at December 31		
Description	Fair Value	(Level 1)	(Level 2)	(Level 3)
2013				
Impaired loans	$ 112,157	$ -	$ -	$ 112,157
Real estate owned	519,660	-	-	519,660
	$ 631,817	$ -	$ -	$ 631,817
2012				
Impaired loans	$ 259,563	$ -	$ -	$ 259,563
Real estate owned	536,583	-	-	536,583
	$ 796,146	$ -	$ -	$ 796,146

The valuation methodologies used for assets and liabilities recorded at fair value on a nonrecurring basis are as follows:

Impaired Loans
The Bank does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management will measure impairment. The fair value of impaired loans is estimated using one of several methods, including collateral value, market price and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At December 31, 2013 and 2012, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. Impaired loans where an allowance is established based on the fair value of collateral or where the loan has been partially charged off as a result of the assessment of impairment require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Bank records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Bank records the impaired loan as nonrecurring Level 3.

At December 31, 2013, total impaired loans were $1,365,029, of which $228,780 were adjusted to fair value through partial charge offs of $116,623 recognized during 2012, resulting in a fair value of $112,157. At December 31, 2012, total impaired loans were $2,396,140. Included in this total were $409,653 in loans adjusted to fair through partial charge offs of $150,000 recognized, resulting in a fair value of $259,563.

NOTE N – FAIR VALUE MEASUREMENTS (Continued)

Real Estate Owned

Real estate owned balances are adjusted to fair value upon transfer of the loans to real estate owned. Real estate acquired in settlement of loans is recorded initially at estimated fair value of the property less estimated selling costs at the date of foreclosure. The initial recorded value may be subsequently reduced by additional allowances, which are charged to earnings if the estimated fair value of the property less estimated selling costs declines below the initial recorded value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Bank records the foreclosed asset as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Bank records the foreclosed real estate asset as nonrecurring Level 3.

For Level 3 assets and liabilities measured at fair value on a recurring or non-recurring basis as of December 31, 2013 and 2012, the significant unobservable inputs used in the fair value measurements were as follows:

Level 3 Assets with Significant Unobservable Inputs	Fair Value	Valuation Technique	Significant Unobservable Inputs	Significant Unobservable Input Value
2013				
Impaired Loans	$ 112,157	Discounted appraisals [1]	Appraisal adjustments [2]	25% to 55%
Real Estate Owned	$ 519,660	Discounted appraisals	Appraisal adjustments [2]	8% to 44%
2012				
Impaired Loans	$ 259,563	Discounted appraisals [1]	Appraisal adjustments [2]	3% to 6%
Real Estate Owned	$ 536,583	Discounted appraisals	Appraisal adjustments [2]	8%

(1) Fair value is generally based on appraisals of the underlying collateral but is also based on discounted cash flows for some loans.

(2) Appraisals may be adjusted by management for customized discounting criteria, estimated sales costs, and proprietary qualitative adjustments.

Impaired loans and real estate and repossessions acquired in settlement of loans classified as Level 3 are based on management's judgment and estimation.

NOTE O - EMPLOYEE AND DIRECTOR BENEFIT PLANS

401(k) Retirement Plan

The Bank has a 401(k) retirement plan that covers all eligible employees. The Bank matches 100% of employee contributions on the first 3% of each employee's covered compensation and 50% of employee contributions on the next 2% of each employee's covered compensation. Matching contributions are funded when accrued. Matching expenses totaled approximately $100,000 and $92,000 for the years ended December 31, 2013 and 2012, respectively.

Supplemental Executive Retirement Plan

In December 2013, the Bank adopted a supplemental executive retirement plan. The liability for this obligation will commence on January 1, 2014, calculated by discounting the anticipated future cash flows in accordance with the plan.

Stock Repurchase Plan

During 2013, the Board of Directors approved the Bank to repurchase up to 56,485 outstanding shares of common stock, for a total repurchase price not to exceed $525,000. The repurchased shares must be in accordance with the terms of the plan, and repurchases cannot be executed that would result in the Bank to have less than well-capitalized status with regulatory capital ratios. During 2013, the Bank repurchased and retired 31,058 shares for $321,327.

Stock Option Plan

During 1999 the Bank adopted, with shareholder approval, an Employee Stock Option Plan (the "Employee Plan"). During 2004 the Bank adopted, with shareholder approval, a Director Nonstatutory Stock Option Plan (the "Director Plan"). Certain options granted under the Employee Plan vested immediately at the time of grant, with the remainder vesting over five to six years. None of the options in the Director Plan had been granted as of December 31, 2013. All unexercised options expire ten years after the date of grant.

During 2012 the Bank adopted, with shareholder approval, an Omnibus Incentive Plan (the "Plan"). As of December 31, 2012, there were 297,675 shares available for grant, after adjusting for the 5% stock dividend during 2013. As of December 31, 2013, there were 210,630 shares available for grant. The Plan allows for grants in the form of stock options, restricted stock and performance units. Employees and Directors are both eligible to receive grants under the Plan.

Restricted Stock Awards

Restricted stock awards are subject to restrictions and the risk of forfeiture if conditions stated in the award agreement are not satisfied at the end of a restriction period. During the restriction period, restricted stock covered by the award will be held by the Bank. If the conditions stated in the award agreement are satisfied at the end of the restriction period, the restricted stock will become unrestricted and the certificate evidencing the stock will be delivered to the employee.

NOTE O - EMPLOYEE AND DIRECTOR BENEFIT PLANS (Continued)

Restricted Stock Awards (Continued)

After adjusting for the 5% stock dividend during 2013, there were 36,645 shares of restricted stock awarded during 2013, of which 7,140 shares vested immediately and the remaining were non-vested on December 31, 2013. There were no shares of non-vested restricted stock outstanding on December 31, 2012. The weighted average grant date fair value of the 36,495 shares awarded in 2013 was $10.08. The aggregate intrinsic value of the shares was $399,430.

Stock based compensation expense resulting from restricted stock awards was approximately $141,000 for the year ended December 31, 2013.

Stock Options

Stock options may be issued as incentive stock options or as nonqualified stock options. The term of the option will be established at the time it is granted but shall not exceed ten years. Vesting will also be established at the time the option is granted. The exercise price may not be less than the fair market value of a share of common stock on the date the option is granted.

Stock based compensation expense charged to income was approximately $15,000 and $2,000 for the years ended December 31, 2013 and 2012, respectively. No income tax benefit was recognized for sharebased compensation, as the Bank does not have any outstanding nonqualified stock options.

A summary of the Bank's option plans as of and for the years ended December 31, 2013 is as follows:

	Outstanding Options			
	Shares Available for Future Grants	Number Outstanding	Weighted Average Exercise Price	Aggregate Intrinsic Value
At December 31, 2012	70,355	62,582	$ 11.48	$ -
Options granted	-	50,400	9.62	
Options expired	-	-	-	
Options exercised	-	-	-	
Options forfeited	-	7,977	10.34	
At December 31, 2013	70,355	105,005	$ 10.59	$ 112,785
Options exercisable at December 31, 2013		54,605	$ 11.48	$ 48,223

NOTE O - EMPLOYEE AND DIRECTOR BENEFIT PLANS (Continued)

Stock Option Plan (Continued)

The following table summarizes information about the stock options outstanding at December 31, 2013:

	Options Outstanding		Options Exercisable	
Exercise Price	Number Outstanding December 31, 2013	Weighted-Average Remaining Contractual Life (Years)	Number Exercisable December 31, 2013	Weighted-Average Exercise Price
$6.00 - $9.00	14,657	1.16	14,657	$ 8.58
$9.01 - $13.00	75,926	7.01	25,526	10.34
$13.01 - $18.00	14,422	3.09	14,422	16.45
	105,005	5.65	54,605	$ 11.48

The weighted average fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option-pricing model.

There were 50,400 options granted during the year ended December 31, 2013. The weighted average fair value of the options granted in 2013 was $3.03 and was determined as of the date of grant using the Black-Scholes option pricing model, assuming the following weighted average assumptions: a risk-free interest rate of 2.00%, a dividend yield of 0%, volatility of 31.34%, and an expected life of seven years. There were no options exercised during the years ended December 31, 2013 and 2012.

A summary of the status of the Bank's non-vested stock options as of December 31, 2013 and 2012, and changes during the year then ended is presented below:

	Shares	Weighted Average Grant Date Fair Value
Non-vested December 31, 2011	3,267	$ 7.00
Granted	-	-
Vested	(3,267)	7.00
Forfeited	-	-
Non-vested December 31, 2012	-	-
Granted	50,400	3.03
Vested	-	-
Forfeited	-	-
Non-vested December 31, 2013	50,400	$ 3.03

The total fair value of shares that contractually vested during the year ended December 31, 2013 and 2012 is approximately $0 and $22,000, respectively.

NOTE O - EMPLOYEE AND DIRECTOR BENEFIT PLANS (Continued)

Employment Contracts

The Bank has entered into employment agreements with certain of its executive officers to ensure a stable and competent management base. The agreements provide for benefits as enumerated in the contracts and cannot be terminated by the Board of Directors, except for cause, without prejudicing the officers' rights to receive certain vested rights, including compensation. In the event of a change in control of the Bank and in certain other events, as defined in the agreements, the Bank or any successor to the Bank will be bound to the terms of the contracts.

NOTE P - OTHER NONINTEREST EXPENSE

The major components of other noninterest expense for the years ended December 31, 2013 and 2012 are as follows:

	2013	2012
Professional services	$ 243,217	$ 231,912
Office supplies	116,218	123,710
Postage and courier	91,310	89,388
Telephone	138,382	127,852
FDIC premiums and assessments	164,000	185,000
Net loss on sale and expenses of real estate owned	150,183	95,916
Loan collection fees	60,361	130,688
Commercial deposit charge-off	25,034	278,329
Other	364,259	391,998
Total	$ 1,352,964	$ 1,654,793

BOARD OF DIRECTORS

DR. RAYMOND BALL, JR.

MARTY BEAM

JOSEPH E. BLIZZARD

ROBERT LEE BURROWS, JR.*

LAWRENCE DAVENPORT

*Chairman

JAMES T. HILL, JR.

DWIGHT HOWARD

VINCENT ROBERT JONES

CAMERON MCRAE

DAVID WEIL

DAVID WOMACK

OFFICERS AND MANAGEMENT

VINCENT ROBERT JONES
President/
Chief Executive Officer

DOYLE M. THIGPEN
Executive Vice President/
Chief Financial Officer/
Corporate Secretary

CHRISTOPHER O. ROBBINS
Executive Vice President/
Chief Credit Officer

SUSAN W. BARRETT
Executive Vice President/
Operations Manager

CHRISTOPHER MONCOURTOIS
Senior Vice President/
Jacksonville City Executive

ROY J. PARKER, III
Senior Vice President/
Goldsboro City Executive

WALTER S. NEWTON, II
Senior Vice President/
Kinston City Executive

PEGGY CHRISTOPHER
Senior Vice President/
Greenville City Executive

VIVIAN C. SUTTON
Vice President/
LaGrange City Executive

J. STEPHEN WOOLARD, JR
Vice President/
New Bern Market Manager

JONATHAN JOYNER
Senior Vice President/
Wilmington City Executive

DALLAS TAYLOR
Senior Vice President/
Loan Review Officer

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Kinston, NC 28501-0279
(252) 939-3900

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Regulatory and Securities Counsel
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Humphrey & Leonard, L.L.P.
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230 North Elm Street
Post Office Box 26000
Greensboro, NC 27420

Market for Common Stock

the little bank's common stock is traded on the OTC Bulletin Board. It is traded under the symbol LTLB. There are approximately 219 shareholders of record.

Annual Shareholders' Meeting

The annual meeting of the shareholders of the Bank will be held at 10:00 a.m. April 24, 2014 at the Hampton Inn on Highway 258 South, Kinston, NC.

These audited financial statements serves as the annual financial disclosure statement furnished pursuant to the Federal Deposit Insurance Corporation's rules and regulations. This statement has not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.