FIRST BANCORP /NC/
Form 10-Q
August 09, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2018

Commission File Number 0-15572

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

North Carolina (State or Other Jurisdiction of Incorporation or Organization)	56-1421916 (I.R.S. Employer Identification Number)
300 SW Broad St., Southern Pines, North Carolina (Address of Principal Executive Offices)	28387 (Zip Code)

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

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

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

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

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

Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933 (§230.405 of this chapter) or Rule 12b-2 of the Securities Exchange Act of 1934 (§240.12b-2 of this chapter). o Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

The number of shares of the registrant's Common Stock outstanding on July 31, 2018 was 29,702,912.

INDEX

FIRST BANCORP AND SUBSIDIARIES

Index

FORWARD-LOOKING STATEMENTS

Part I of this report contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 and the Private Securities Litigation Reform Act of 1995, which statements are inherently subject to risks and uncertainties. Forward-looking statements are statements that include projections, predictions, expectations or beliefs about future events or results or otherwise are not statements of historical fact. Further, forward-looking statements are intended to speak only as of the date made. Such statements are often characterized by the use of qualifying words (and their derivatives) such as “expect,” “believe,” “estimate,” “plan,” “project,” or other statement concerning our opinions or judgment about future events. Our actual results may differ materially from those anticipated in any forward-looking statements, as they will depend on many factors about which we are unsure, including many factors which are beyond our control. Factors that could influence the accuracy of such forward-looking statements include, but are not limited to, the financial success or changing strategies of our customers, our level of success in integrating acquisitions, actions of government regulators, the level of market interest rates, and general economic conditions. For additional information about factors that could affect the matters discussed in this paragraph, see the “Risk Factors” section of our 2017 Annual Report on Form 10-K.

Index

Part I. Financial Information

Item 1 - Financial Statements

First Bancorp and Subsidiaries

Consolidated Balance Sheets

($ in thousands-unaudited)	June 30, 2018	December 31, 2017 (audited)	June 30, 2017
ASSETS			
Cash and due from banks, noninterest-bearing	$97,163	114,301	80,234
Due from banks, interest-bearing	462,972	375,189	337,326
Total cash and cash equivalents	560,135	489,490	417,560
Securities available for sale	334,068	343,270	207,496
Securities held to maturity (fair values of $107,068, $118,998, and $129,697)	108,265	118,503	127,866
Presold mortgages in process of settlement	9,311	12,459	13,071
Loans	4,149,390	4,042,369	3,375,976
Allowance for loan losses	(23,298)	(23,298)	(24,025)
Net loans	4,126,092	4,019,071	3,351,951
Premises and equipment	113,774	116,233	96,605
Accrued interest receivable	13,930	14,094	10,830
Goodwill	232,458	233,070	139,124
Other intangible assets	23,152	24,437	12,132
Foreclosed real estate	8,296	12,571	11,196
Bank-owned life insurance	100,413	99,162	87,501
Other assets	87,706	64,677	53,288
Total assets	$5,717,600	5,547,037	4,528,620
LIABILITIES			
Deposits: Noninterest bearing checking accounts	$1,252,214	1,196,161	990,004
Interest bearing checking accounts	915,666	884,254	728,973
Money market accounts	1,021,659	984,945	782,963
Savings accounts	440,475	454,860	411,814
Time deposits of $100,000 or more	647,206	593,123	479,839
Other time deposits	276,401	293,612	250,737
Total deposits	4,553,621	4,406,955	3,644,330
Borrowings	407,076	407,543	355,405

Accrued interest payable	1,651	1,235	1,014
Other liabilities	30,530	38,325	27,220
Total liabilities	4,992,878	4,854,058	4,027,969
Commitments and contingencies			
SHAREHOLDERS' EQUITY			
Preferred stock, no par value per share. Authorized: 5,000,000 shares			
Series C, convertible, issued & outstanding: none, none, and none	—	—	—
Common stock, no par value per share. Authorized: 40,000,000 shares			
Issued & outstanding: 29,702,912, 29,639,374, and 24,678,295 shares	434,117	432,794	262,901
Retained earnings	301,800	264,331	240,682
Stock in rabbi trust assumed in acquisition	(3,214)	(3,581)	(4,257)
Rabbi trust obligation	3,214	3,581	4,257
Accumulated other comprehensive income (loss)	(11,195)	(4,146)	(2,932)
Total shareholders' equity	724,722	692,979	500,651
Total liabilities and shareholders' equity	$5,717,600	5,547,037	4,528,620

See accompanying notes to consolidated financial statements.

Index

First Bancorp and Subsidiaries

Consolidated Statements of Income

($ in thousands, except share data-unaudited)	Three Months Ended June 30, 2018	2017	Six Months Ended June 30, 2018	2017
INTEREST INCOME				
Interest and fees on loans	$51,451	39,656	101,621	73,359
Interest on investment securities:				
Taxable interest income	2,465	1,710	5,051	3,265
Tax-exempt interest income	368	427	748	870
Other, principally overnight investments	2,451	1,034	4,376	1,801
Total interest income	56,735	42,827	111,796	79,295
INTEREST EXPENSE				
Savings, checking and money market accounts	1,132	685	2,111	1,207
Time deposits of $100,000 or more	1,850	874	3,325	1,588
Other time deposits	251	173	470	339
Borrowings	2,270	1,179	4,151	1,949
Total interest expense	5,503	2,911	10,057	5,083
Net interest income	51,232	39,916	101,739	74,212
Provision (reversal) for loan losses	(710)	—	(4,369)	723
Net interest income after provision for loan losses	51,942	39,916	106,108	73,489
NONINTEREST INCOME				
Service charges on deposit accounts	3,122	2,966	6,385	5,580
Other service charges, commissions and fees	4,913	3,554	9,510	6,727
Fees from presold mortgage loans	796	1,511	1,655	2,279
Commissions from sales of insurance and financial products	2,119	1,038	4,059	1,878
SBA consulting fees	1,126	1,050	2,267	2,310
SBA loan sale gains	2,598	927	6,400	1,549
Bank-owned life insurance income	628	580	1,251	1,088
Foreclosed property gains (losses), net	(99)	(248)	(387)	(223)
Securities gains (losses), net	—	—	—	(235)
Other gains (losses), net	908	497	912	731
Total noninterest income	16,111	11,875	32,052	21,684
NONINTEREST EXPENSES				
Salaries expense	18,446	16,299	37,844	30,249
Employee benefits expense	4,084	4,042	8,691	7,952
Total personnel expense	22,530	20,341	46,535	38,201
Occupancy expense	2,543	2,358	5,345	4,542
Equipment related expenses	1,241	1,363	2,493	2,421
Merger and acquisition expenses	640	1,122	3,401	3,495
Intangibles amortization expense	1,745	1,031	3,417	1,607

Other operating expenses	10,174	8,869	21,280	16,890
Total noninterest expenses	38,873	35,084	82,471	67,156
Income before income taxes	29,180	16,707	55,689	28,017
Income tax expense	6,450	5,553	12,286	9,308
Net income available to common shareholders	$22,730	11,154	43,403	18,709
Earnings per common share:				
Basic	$0.77	0.45	1.47	0.80
Diluted	0.77	0.45	1.46	0.80
Dividends declared per common share	$0.10	0.08	0.20	0.16
Weighted average common shares outstanding:				
Basic	29,544,747	24,593,307	29,539,308	23,288,635
Diluted	29,632,738	24,671,550	29,630,822	23,368,503

See accompanying notes to consolidated financial statements.

Index
First Bancorp and Subsidiaries

Consolidated Statements of Comprehensive Income

($ in thousands-unaudited)	Three Months Ended June 30, 2018	2017	Six Months Ended June 30, 2018	2017
Net income	$22,730	11,154	43,403	18,709
Other comprehensive income (loss):				
Unrealized gains (losses) on securities available for sale:				
Unrealized holding gains (losses) arising during the period, pretax	(2,012)	1,989	(9,302)	3,102
Tax (expense) benefit	471	(737)	2,174	(1,144)
Reclassification to realized (gains) losses	—	—	—	235
Tax expense (benefit)	—	—	—	(87)
Postretirement Plans:				
Amortization of unrecognized net actuarial (gain) loss	51	54	103	105
Tax expense (benefit)	(12)	(16)	(24)	(36)
Other comprehensive income (loss)	(1,502)	1,290	(7,049)	2,175
Comprehensive income	$21,228	12,444	36,354	20,884

See accompanying notes to consolidated financial statements.

Index

First Bancorp and Subsidiaries

Consolidated Statements of Shareholders' Equity

(In thousands, except per share - unaudited)	Common Stock Shares	Common Stock Amount	Retained Earnings	Stock in Rabbi Trust Assumed in Acquisition	Rabbi Trust Obligation	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances, January 1, 2017	20,845	$147,287	225,921	—	—	(5,107)	368,101
Net income			18,709				18,709
Cash dividends declared ($0.16 per common share)			(3,948)				(3,948)
Equity issued pursuant to acquisition	3,799	114,478		(7,688)	7,688		114,478
Payment of deferred fees				3,431	(3,431)		—
Stock option exercises	16	287					287
Stock-based compensation	18	849					849
Other comprehensive income (loss)						2,175	2,175
Balances, June 30, 2017	24,678	$262,901	240,682	(4,257)	4,257	(2,932)	500,651
Balances, January 1, 2018	29,639	$432,794	264,331	(3,581)	3,581	(4,146)	692,979
Net income			43,403				43,403
Cash dividends declared ($0.20 per common share)			(5,934)				(5,934)
Payment of deferred fees				367	(367)		—
Stock option exercises	25	324					324
Stock withheld for payment of taxes	(4)	—					—
Stock-based compensation	43	999					999
Other comprehensive income (loss)						(7,049)	(7,049)
Balances, June 30, 2018	29,703	$434,117	301,800	(3,214)	3,214	(11,195)	724,722

See accompanying notes to consolidated financial statements.

Index
First Bancorp and Subsidiaries

Consolidated Statements of Cash Flows

($ in thousands-unaudited)	Six Months Ended June 30, 2018	2017
Cash Flows From Operating Activities		
Net income	$43,403	18,709
Reconciliation of net income to net cash provided (used) by operating activities:		
Provision (reversal) for loan losses	(4,369)	723
Net security premium amortization	1,476	1,470
Loan discount accretion	(4,407)	(3,328)
Purchase accounting accretion and amortization, net	(125)	(122)
Foreclosed property (gains) losses and write-downs, net	387	223
Loss (gain) on securities available for sale	—	235
Other losses (gains)	(912)	(731)
Decrease (increase) in net deferred loan fees	(955)	759
Depreciation of premises and equipment	2,859	2,708
Stock-based compensation expense	827	683
Amortization of intangible assets	3,417	1,607
Fees/gains from sale of presold mortgages and SBA loans	(8,055)	(3,828)
Origination of presold mortgages in process of settlement	(70,056)	(109,454)
Proceeds from sales of presold mortgages in process of settlement	74,729	107,986
Origination of SBA loans for sale	(110,116)	(27,432)
Proceeds from sales of SBA loans	88,811	22,260
(Increase) decrease in accrued interest receivable	164	(27)
(Increase) decrease in other assets	(14,988)	2,810
Increase in accrued interest payable	416	211
Decrease in other liabilities	(7,504)	(11,886)
Net cash provided (used) by operating activities	(4,998)	3,576
Cash Flows From Investing Activities		
Purchases of securities available for sale	(18,850)	(29,809)
Purchases of securities held to maturity	—	(291)
Proceeds from maturities/issuer calls of securities available for sale	17,835	15,497
Proceeds from maturities/issuer calls of securities held to maturity	9,679	13,683
Proceeds from sales of securities available for sale	—	45,601
Purchases of Federal Reserve and Federal Home Loan Bank stock, net	(6,099)	(6,527)
Net increase in loans	(73,471)	(162,197)
Proceeds from sales of foreclosed real estate	4,619	4,610
Purchases of premises and equipment	(1,959)	(2,135)
Proceeds from sales of premises and equipment	2,579	—
Net cash received in acquisition	—	56,185
Net cash used by investing activities	(65,667)	(65,383)
Cash Flows From Financing Activities		
Net increase in deposits	146,882	111,756

Net increase (decrease) in borrowings	(558)	64,973
Cash dividends paid – common stock	(5,338)	(3,642)
Proceeds from stock option exercises	324	287
Net cash provided by financing activities	141,310	173,374
Increase in cash and cash equivalents	70,645	111,567
Cash and cash equivalents, beginning of period	489,490	305,993
Cash and cash equivalents, end of period	$560,135	417,560
Supplemental Disclosures of Cash Flow Information:		
Cash paid during the period for:		
Interest	$9,641	4,872
Income taxes	10,190	8,570
Non-cash transactions:		
Unrealized gain (loss) on securities available for sale, net of taxes	(7,128)	2,106
Foreclosed loans transferred to other real estate	1,913	3,415

See accompanying notes to consolidated financial statements.

Index

First Bancorp and Subsidiaries

Notes to Consolidated Financial Statements

(*unaudited)* For the Periods Ended June 30, 2018 and 2017

Note 1 - Basis of Presentation

In the opinion of the Company, the accompanying unaudited consolidated financial statements contain all adjustments necessary to present fairly the consolidated financial position of the Company as of June 30, 2018 and 2017 and the consolidated results of operations and consolidated cash flows for the periods ended June 30, 2018 and 2017. All such adjustments were of a normal, recurring nature. Reference is made to the 2017 Annual Report on Form 10-K filed with the SEC for a discussion of accounting policies and other relevant information with respect to the financial statements. The results of operations for the periods ended June 30, 2018 and 2017 are not necessarily indicative of the results to be expected for the full year. The Company has evaluated all subsequent events through the date the financial statements were issued.

Note 2 – Accounting Policies

Note 1 to the 2017 Annual Report on Form 10-K filed with the SEC contains a description of the accounting policies followed by the Company and a discussion of recent accounting pronouncements. The following paragraphs update that information as necessary.

Accounting Standards Adopted in 2018

In May 2014, the Financial Accounting Standards Board ("FASB") issued guidance to change the recognition of revenue from contracts with customers. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The Company's revenue is comprised of net interest income and noninterest income. The scope of the guidance explicitly excludes net interest income as well as many other revenues for financial assets and liabilities including loans, leases, securities, and derivatives. Accordingly, the majority of the Company's revenues were not affected. The guidance was effective for the Company on January 1, 2018 and the Company adopted the guidance using the modified retrospective method. The adoption did not have a material effect on the Company's financial statements.

In January 2016, the FASB amended the Financial Instruments topic of the Accounting Standards Codification to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. This update is intended to improve the recognition and measurement of financial instruments and it requires an entity to: (i) measure equity investments at fair value through net income, with certain exceptions; (ii) present in other comprehensive income the changes in instrument-specific credit risk for financial liabilities measured using the fair value option; (iii) present financial assets and financial liabilities by measurement category and form of financial asset; (iv) calculate the fair value of financial instruments for disclosure purposes based on an exit price and; (v) assess a valuation allowance on deferred tax assets related to unrealized losses of available for sale debt securities in combination with other deferred tax assets. The guidance also provides an election to subsequently measure certain nonmarketable equity investments at cost less any impairment and adjusted for certain observable price changes and requires a qualitative impairment assessment of such equity investments and amends certain fair value disclosure requirements. The amendments were effective for the Company on January 1, 2018 and the adoption of the guidance did not have a material effect on its financial statements.

In March 2016, the FASB amended the Liabilities topic of the Accounting Standards Codification to address the current and potential future diversity in practice related to the derecognition of a prepaid stored-value product liability. The amendments were effective for the Company on January 1, 2018 and did not have a material effect on its financial statements.

In March 2017, the FASB amended the requirements in the Compensation—Retirement Benefits topic of the Accounting Standards Codification related to the income statement presentation of the components of net periodic benefit cost for an entity’s sponsored defined benefit pension and other postretirement plans. The amendments require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by pertinent employees during the period. The other components of net periodic benefit cost are required to be presented in the income statement separately from the service cost component. The amendments were effective for the Company on January 1, 2018 and did not have a material effect on its financial statements.

Index

In February 2018, the FASB issued guidance related to the Income Statement – Reporting Comprehensive Income topic of the Accounting Standards Codification, which allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017, which was signed into law on December 22, 2017. The guidance will be effective for all annual and interim periods beginning January 1, 2019, with early adoption permitted. The Company chose to early adopt the new standard for the year ending December 31, 2017, as allowed under the new standard, and reclassified $0.7 million between Accumulated Other Comprehensive Income and Retained Earnings.

Accounting Standards Pending Adoption

In February 2016, the FASB issued new guidance on accounting for leases, which generally requires all leases to be recognized in the statement of financial position by recording an asset representing its right to use the underlying asset and recording a liability, which represents the Company’s obligation to make lease payments. The provisions of this guidance are effective for reporting periods beginning after December 15, 2018; early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

In June 2016, the FASB issued guidance to change the accounting for credit losses. The guidance requires an entity to utilize a new impairment model known as the current expected credit loss ("CECL") model to estimate its lifetime "expected credit loss" and record an allowance that, when deducted from the amortized cost basis of the financial asset, presents the net amount expected to be collected on the financial asset. The CECL model is expected to result in earlier recognition of credit losses. The guidance also requires new disclosures for financial assets measured at amortized cost, loans and available-for-sale debt securities. The Company will apply the guidance through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption. While early adoption is permitted beginning in first quarter 2019, the Company does not expect to elect that option. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2019. The Company is currently evaluating the impact of this guidance on its consolidated financial statements; however, the Company expects the adoption of this guidance will result in a significant increase in its recorded allowance for loan losses.

In January 2017, the FASB amended the Goodwill and Other Intangibles topic of the Accounting Standards Codification to simplify the accounting for goodwill impairment for public business entities and other entities that have goodwill reported in their financial statements and have not elected the private company alternative for the subsequent measurement of goodwill. The amendment removes Step 2 of the goodwill impairment test. The amount of goodwill impairment will now be the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The effective date and transition requirements for the technical corrections will be effective for the Company for reporting periods beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not expect this amendment to have a material effect on its financial statements.

In March 2017, the FASB amended the requirements in the Receivables—Nonrefundable Fees and Other Costs topic of the Accounting Standards Codification related to the amortization period for certain purchased callable debt securities held at a premium. The amendments shorten the amortization period for the premium to the earliest call date. The amendments will be effective for the Company for interim and annual periods beginning after December 15, 2018. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

In June 2018, the FASB amended the Compensation—Stock Compensation Topic of the Accounting Standards Codification. The amendments expand the scope of this Topic to include share-based payment transactions for acquiring goods and services from nonemployees. The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. Early adoption is permitted, but no earlier than an entity's adoption date of the Revenue from Contracts with Customers Topic. The Company does not expect these amendments to have a material effect on its financial statements.

Index

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

Note 3 – Reclassifications

Certain amounts reported in the period ended June 30, 2017 have been reclassified to conform to the presentation for June 30, 2018. These reclassifications had no effect on net income or shareholders' equity for the periods presented, nor did they materially impact trends in financial information.

Note 4 – Acquisitions

Since January 1, 2017, the Company completed the acquisitions described below. The results of each acquired company are included in the Company's results beginning on its respective acquisition date.

(1) On March 3, 2017, the Company completed the acquisition of Carolina Bank Holdings, Inc. ("Carolina Bank"), headquartered in Greensboro, North Carolina, pursuant to an Agreement and Plan of Merger and Reorganization dated June 21, 2016. The results of Carolina Bank are included in First Bancorp's results beginning on the March 3, 2017 acquisition date.

Carolina Bank Holdings, Inc. was the parent company of Carolina Bank, a North Carolina state-charted bank with eight bank branches located in the North Carolina cities of Greensboro, High Point, Burlington, Winston-Salem, and Asheboro, and mortgage offices in Burlington, Hillsborough, and Sanford. The acquisition complemented the Company's expansion into several of these high-growth markets and increased its market share in others with facilities, operations and experienced staff already in place. The Company was willing to record goodwill primarily due to the reasons just noted, as well as the positive earnings of Carolina Bank. The total merger consideration consisted of \$25.3 million in cash and 3,799,471 shares of the Company's common stock, with each share of Carolina Bank common stock being exchanged for either \$20.00 in cash or 1.002 shares of the Company's stock, subject to the total consideration being 75% stock / 25% cash. The issuance of common stock was valued at \$114.5 million and was based on the Company's closing stock price on March 3, 2017 of \$30.13 per share.

This acquisition was accounted for using the purchase method of accounting for business combinations, and accordingly, the assets and liabilities of Carolina Bank were recorded based on estimates of fair values as of March 3, 2017. The Company was able to change its valuations of acquired Carolina Bank assets and liabilities for up to one year after the acquisition date. The table below is a condensed balance sheet disclosing the amount assigned to each major asset and liability category of Carolina Bank on March 3, 2017, and the related fair value adjustments recorded by the Company to reflect the acquisition. The \$65.1 million in goodwill that resulted from this transaction is non-deductible for tax purposes.

Index

($ in thousands)	As Recorded by Carolina Bank	Initial Fair Value Adjustments		Measurement Period Adjustments		As Recorded by First Bancorp
Assets						
Cash and cash equivalents	$81,466	(2	)(a)	—		81,464
Securities	49,629	(261	)(b)	—		49,368
Loans, gross	505,560	(5,469	)(c)	146	(l)	497,522
		(2,715	)(d)	—		
Allowance for loan losses	(5,746)	5,746	(e)	—		—
Premises and equipment	17,967	4,251	(f)	(319	)(m)	21,899
Core deposit intangible	—	8,790	(g)	—		8,790
Other	34,976	(4,804	)(h)	2,225	(n)	32,397
Total	683,852	5,536		2,052		691,440
Liabilities						
Deposits	$584,950	431	(i)	—		585,381
Borrowings	21,855	(2,855	)(j)	(262	)(o)	18,738
Other	12,855	225	(k)	(444	)(p)	12,636
Total	619,660	(2,199	)	(706	)	616,755
Net identifiable assets acquired						74,685
Total cost of acquisition						
Value of stock issued		$ 114,478				
Cash paid in the acquisition		25,279				
Total cost of acquisition						139,757
Goodwill recorded related to acquisition of Carolina Bank						$65,072

Explanation of Fair Value Adjustments

(a) This adjustment was recorded to a short-term investment to its estimated fair value.

(b) This fair value adjustment was recorded to adjust the securities portfolio to its estimated fair value.

(c) This fair value adjustment represents the amount necessary to reduce performing loans to their fair value due to interest rate factors and credit factors. Assuming the loans continue to perform, this amount will be amortized to increase interest income over the remaining lives of the related loans.

(d) This fair value adjustment was recorded to write-down purchased credit impaired loans assumed in the acquisition to their estimated fair market value.

(e) This fair value adjustment reduced the allowance for loan losses to zero as required by relevant accounting guidance.

(f) This adjustment represents the amount necessary to increase premises and equipment from its book value on the date of acquisition to its estimated fair market value.

(g) This fair value adjustment represents the value of the core deposit base assumed in the acquisition based on a study performed by an independent consulting firm. This amount was recorded by the Company as an identifiable intangible asset and will be amortized as expense on an accelerated basis over seven years.

(h) This fair value adjustment primarily represents the net deferred tax liability associated with the other fair value adjustments made to record the transaction.

(i) This fair value adjustment was recorded because the weighted average interest rate of Carolina Bank's time deposits exceeded the cost of similar wholesale funding at the time of the acquisition. This amount is being amortized to reduce interest expense on an accelerated basis over their remaining five year life.

(j) This fair value adjustment was primarily recorded because the interest rate of Carolina Bank's trust preferred securities was less than the current interest rate on similar instruments. This amount is being amortized on approximately a straight-line basis to increase interest expense over the remaining life of the related borrowing, which is 18 years.

(k) This fair value adjustment represents miscellaneous adjustments needed to record assets and liabilities at their fair value.

(l) This fair value adjustment was a miscellaneous adjustment to increase the initial fair value of gross loans.

(m) This fair value adjustment relates to miscellaneous adjustment to decrease the initial fair value of premises and equipment.

(n) This fair value adjustment relates to changes in the estimate of deferred tax assets/liabilities associated with the acquisition and adjustments to decrease the initial fair value of the foreclosed real estate acquired in the transaction based on newly obtained valuations.

Index

(o) This fair value adjustment relates to miscellaneous adjustments to decrease the initial fair value of borrowings.

(p) This fair value adjustment relates to a change in the estimate of a contingent liability.

The following unaudited pro forma financial information presents the combined results of the Company and Carolina Bank as if the acquisition had occurred as of January 1, 2016, after giving effect to certain adjustments, including amortization of the core deposit intangible, and related income tax effects. The pro forma financial information does not necessarily reflect the results of operations that would have occurred had the Company and Carolina Bank constituted a single entity during such period.

($ in thousands, except share data)	Carolina Bank earnings - March 3, 2017 to June 30, 2017 - included in Company's earnings for the six months ended June 30, 2017	Pro Forma Combined Six Months Ended June 30, 2017
Net interest income	$ 8,778	78,260
Noninterest income	1,871	22,874
Total revenue	10,649	101,134
Net income available to common shareholders	2,275	21,229
Earnings per common share		
Basic		$ 0.86
Diluted		0.86

The above pro forma results for the six months ended June 30, 2017 include merger-related expenses and charges recorded by Carolina Bank prior to the acquisition that are nonrecurring in nature and amounted to $4.6 million pretax, or $3.1 million after-tax ($0.12 per basic and diluted share).

(2) On September 1, 2017, First Bank Insurance completed the acquisition of Bear Insurance Service ("Bear Insurance"). The results of Bear Insurance are included the Company's results beginning on the September 1, 2017 acquisition date.

Bear Insurance, an insurance agency based in Albemarle, North Carolina, with four locations in Stanly, Cabarrus, and Montgomery counties and annual commission income of approximately $4 million, represented an opportunity to complement the Company's insurance agency operations in these markets and the surrounding areas. Also, this acquisition provided the Company with a larger platform for leveraging insurance services throughout the Company's bank branch network. The transaction value was $9.8 million, with the Company paying $7.9 million in cash and issuing 13,374 shares of its common stock, which had a value of approximately $0.4 million. Per the terms of the agreement, the Company also recorded an earn-out liability valued at $1.2 million, which will be paid as a cash distribution after a four-year period if pre-determined goals are met for the periods.

This acquisition was accounted for using the purchase method of accounting for business combinations, and accordingly, the assets and liabilities of Bear Insurance were recorded based on estimates of fair values as of September 1, 2017. In connection with this acquisition, the Company recorded $5.3 million in goodwill, which is deductible for tax purposes, and $3.9 million in other amortizable intangible assets, which are also deductible for tax purposes.

(3) On October 1, 2017, the Company completed the acquisition of ASB Bancorp, Inc. ("Asheville Savings Bank"), headquartered in Asheville, North Carolina, pursuant to an Agreement and Plan of Merger and Reorganization dated May 1, 2017. The results of Asheville Savings Bank are included in First Bancorp's results beginning on the October 1, 2017 acquisition date.

ASB Bancorp, Inc. was the parent company of Asheville Savings Bank, a North Carolina state-chartered savings bank with eight bank branches located in Buncombe County, North Carolina and five bank branches located in the counties of Henderson, Madison, McDowell and Transylvania, all in North Carolina. The acquisition complemented the Company's existing presence in the Asheville and surrounding markets, which are high-growth and highly desired markets. The Company was willing to record goodwill primarily due to the reasons just noted, as well as the positive earnings of Asheville Savings Bank. The total merger consideration consisted of $17.9 million in cash and 4,920,061 shares of the Company's common stock, with each share of Asheville Savings Bank common stock being exchanged for either $41.90 in cash or 1.44 shares of the Company's stock, subject to the total consideration being 90% stock / 10% cash. The issuance of common stock was valued at $169.3 million and was based on the Company's closing stock price on September 30, 2017 of $34.41 per share.

Index

This acquisition was accounted for using the purchase method of accounting for business combinations, and accordingly, the assets and liabilities of Asheville Savings Bank were recorded based on estimates of fair values as of October 1, 2017. The Company may change its valuations of acquired Asheville Savings Bank assets and liabilities for up to one year after the acquisition date. The table below is a condensed balance sheet disclosing the amount assigned to each major asset and liability category of Asheville Savings Bank on October 1, 2017, and the related fair value adjustments recorded by the Company to reflect the acquisition. The $88.2 million in goodwill that resulted from this acquisition is non-deductible for tax purposes.

($ in thousands)	As Recorded by Asheville Savings Bank	Initial Fair Value Adjustments		Measurement Period Adjustments		As Recorded by First Bancorp
Assets						
Cash and cash equivalents	$41,824	—		—		41,824
Securities	95,020	—		—		95,020
Loans, gross	617,159	(9,631)	(a)	—		606,180
		(1,348)	(b)	—		
Allowance for loan losses	(6,685)	6,685	(c)	—		—
Presold mortgages	3,785	—		—		3,785
Premises and equipment	10,697	9,857	(d)	—		20,554
Core deposit intangible	—	9,760	(e)	120	(i)	9,880
Other	35,944	(5,851)	(f)	(777)	(j)	29,316
Total	797,744	9,472		(657)		806,559
Liabilities						
Deposits	$678,707	430	(g)	—		679,137
Borrowings	20,000	—		—		20,000
Other	8,943	298	(h)	(822)	(k)	8,419
Total	707,650	728		(822)		707,556
Net identifiable assets acquired						99,003
Total cost of acquisition						
Value of stock issued		$ 169,299				
Cash paid in the acquisition		17,939				
Total cost of acquisition						187,238
Goodwill recorded related to acquisition of Asheville Savings Bank						$88,235

Explanation of Fair Value Adjustments

(a) This fair value adjustment represents the amount necessary to reduce performing loans to their fair value due to interest rate factors and credit factors. Assuming the loans continue to perform, this amount will be amortized to increase interest income over the remaining lives of the related loans.

(b) This fair value adjustment was recorded to write-down purchased credit impaired loans assumed in the acquisition to their estimated fair market value.

(c) This fair value adjustment reduced the allowance for loan losses to zero as required by relevant accounting guidance.

(d) This adjustment represents the amount necessary to increase premises and equipment from its book value on the date of acquisition to its estimated fair market value.

(e) This fair value adjustment represents the value of the core deposit base assumed in the acquisition based on a study performed by an independent consulting firm. This amount was recorded by the Company as an identifiable intangible asset and is being amortized as expense on an accelerated basis over seven years.

(f) This fair value adjustment primarily represents the net deferred tax liability associated with the other fair value adjustments made to record the transaction.

Index

(g) This fair value adjustment was recorded because the weighted average interest rate of Asheville Savings Bank's time deposits exceeded the cost of similar wholesale funding at the time of the acquisition. This amount is being amortized to reduce interest expense on an accelerated basis over their remaining five year life.

(h) This fair value adjustment represents miscellaneous adjustments needed to record assets and liabilities at their fair value.

(i) This fair value adjustment relates to a change in the final amount of the core deposit intangible asset from the amount originally estimated.

(j) This fair value adjustment relates to the write-down of a foreclosed property based on an updated appraisal and the related deferred tax asset adjustment.

(k) This fair value adjustment was recorded to adjust the tax liability assumed on the acquisition date based on updated information.

Note 5 – Stock-Based Compensation Plans

The Company recorded total stock-based compensation expense of $596,000 and $479,000 for the three months ended June 30, 2018 and 2017, respectively, and $827,000 and $683,000 for the six months ended June 30, 2018 and 2017, respectively. Of the $827,000 in expense that was recorded in 2018, approximately $352,000 related to the June 1, 2018 director grants, which are classified as "other operating expenses" in the Consolidated Statements of Income. The remaining $475,000 in expense relates to the employee grants discussed below and is recorded as "salaries expense." Stock based compensation is reflected as an adjustment to cash flows from operating activities on the Company's consolidated statement of cash flows. The Company recognized $193,000 and $243,000 of income tax benefits related to stock based compensation expense in its consolidated income statement for the six months ended June 30, 2018 and 2017, respectively.

At June 30, 2018, the Company had two stock-based compensation plans – 1) the First Bancorp 2014 Equity Plan and 2) the First Bancorp 2007 Equity Plan. The Company's shareholders approved each plan. The First Bancorp 2014 Equity Plan became effective upon the approval of shareholders on May 8, 2014. As of June 30, 2018, the First Bancorp 2014 Equity Plan was the only plan that had shares available for future grants, and there were 771,477 shares remaining available for grant.

The First Bancorp 2014 Equity Plan is intended to serve as a means to attract, retain and motivate key employees and directors and to associate the interests of the Plan's participants with those of the Company and its shareholders. The First Bancorp 2014 Equity Plan allows for both grants of stock options and other types of equity-based compensation, including stock appreciation rights, restricted stock, restricted performance stock, unrestricted stock, and performance units.

Recent equity grants have had service vesting conditions. Compensation expense for these grants is recorded over the requisite service periods. No compensation cost is recognized for grants that do not vest and any previously recognized compensation cost is reversed at forfeiture. The Company issues new shares of common stock when options are exercised.

Certain of the Company’s equity grants contain terms that provide for a graded vesting schedule whereby portions of the award vest in increments over the requisite service period. The Company recognizes compensation expense for awards with graded vesting schedules on a straight-line basis over the requisite service period for each incremental award. Over the past five years, there have only been minimal amounts of forfeitures, and therefore the Company assumes that all awards granted with service conditions only will vest.

As it relates to director equity grants, the Company grants common shares, valued at approximately $32,000, to each non-employee director (currently 11 in total) in June of each year. Compensation expense associated with these director grants is recognized on the date of grant since there are no vesting conditions. On June 1, 2018, the Company granted 8,393 shares of common stock to non-employee directors (763 shares per director), at a fair market value of $41.93 per share, which was the closing price of the Company’s common stock on that date, and which resulted in $352,000 in expense. On June 1, 2017, the Company granted 11,190 shares of common stock to non-employee directors (1,119 shares per director), at a fair market value of $28.59 per share, which was the closing price of the Company’s common stock on that date, and which resulted in $320,000 in expense.

Index

The Company's senior officers receive their annual bonuses earned under the Company's annual incentive plan in a mix of 50% cash and 50% stock, with the stock being subject to a three year vesting term. In the last three years, a total of 54,529 shares of restricted stock have been granted related to performance in the preceding fiscal years (net of an immaterial amount of forfeitures). Total compensation expense associated with those grants was $1.4 million and is being recognized over the respective vesting periods. For the three months ended June 30, 2018 and 2017, total compensation expense related to these grants was $73,000 and $66,000, respectively, and for the six months ended June 30, 2018 and 2017, total compensation expense was $147,000 and $151,000, respectively. The Company expects to record $73,000 in compensation expense during each remaining quarter of 2018.

In the last three years, the Compensation Committee also granted 101,156 shares of stock to various employees of the Company to promote retention (net of an immaterial amount of forfeitures). The total value associated with these grants amounted to $2.7 million, which is being recorded as an expense over their three year vesting periods. For the three months ended June 30, 2018 and 2017, total compensation expense related to these grants was $173,000 and $89,000, respectively, and for the six months ended June 30, 2018 and 2017, total compensation expense was $328,000 and $186,000, respectively. The Company expects to record $211,000 in compensation expense during each remaining quarter of 2018. All grants were issued based on the closing price of the Company's common stock on the date of the grant.

The following table presents information regarding the activity the first six months of 2018 related to the Company's outstanding restricted stock:

	Long-Term Restricted Stock	
	Number of Units	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2018	103,063	$24.08
Granted during the period	32,027	39.10
Vested during the period	(10,626)	17.53
Forfeited or expired during the period	(2,977)	25.21
Nonvested at June 30, 2018	121,487	$ 28.58

In years prior to 2009, stock options were the primary form of equity grant utilized by the Company. The stock options had a term of ten years. Upon a change in control (as defined in the plans), unless the awards remain outstanding or substitute equivalent awards are provided, the awards become immediately vested.

At June 30, 2018, there were 9,000 stock options outstanding related to the Company's two equity-based plans, all with an exercise price of $14.35.

The following table presents information regarding the activity for the first six months of 2018 related to the Company's stock options outstanding:

	Options Outstanding			
	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Contractual Term (years)	Aggregate Intrinsic Value
Balance at January 1, 2018	38,689	$ 16.09		
Granted	—	—		
Exercised	(29,689)	16.61		$ 659,743
Forfeited	—	—		
Expired	—	—		
Outstanding at June 30, 2018	9,000	$ 14.35	0.9	$ 239,040
Exercisable at June 30, 2018	9,000	$ 14.35	0.9	$ 239,040

During the three and six months ended June 30, 2018, the Company received $216,000 and $324,000, respectively, as a result of stock option exercises. During the three and six months ended June 30, 2017, the Company received $242,000 and $287,000, respectively, as a result of stock option exercises.

Index

Note 6 – Earnings Per Common Share

Basic Earnings Per Common Share is calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period, excluding unvested shares of restricted stock. Diluted Earnings Per Common Share is computed by assuming the issuance of common shares for all potentially dilutive common shares outstanding during the reporting period. For the periods presented, the Company's potentially dilutive common stock issuances related to unvested shares of restricted stock and stock option grants under the Company's equity-based plans.

In computing Diluted Earnings Per Common Share, adjustments are made to the computation of Basic Earnings Per Common shares, as follows. As it relates to unvested shares of restricted stock, the number of shares added to the denominator is equal to the number of unvested shares less the assumed number of shares bought back by the Company in the open market at the average market price with the amount of proceeds being equal to the average deferred compensation for the reporting period. As it relates to stock options, it is assumed that all dilutive stock options are exercised during the reporting period at their respective exercise prices, with the proceeds from the exercises used by the Company to buy back stock in the open market at the average market price in effect during the reporting period. The difference between the number of shares assumed to be exercised and the number of shares bought back is included in the calculation of dilutive securities.

If any of the potentially dilutive common stock issuances have an anti-dilutive effect, the potentially dilutive common stock issuance is disregarded.

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

	For the Three Months Ended June 30,					
	2018			2017		
($ in thousands except per share amounts)	Income (Numer-ator)	Shares (Denom-inator)	Per Share Amount	Income (Numer-ator)	Shares (Denom-inator)	Per Share Amount
Basic EPS						
Net income available to common shareholders	$22,730	29,544,747	$ 0.77	$11,154	24,593,307	$ 0.45
Effect of Dilutive Securities	—	87,991		—	78,243	
Diluted EPS per common share	$22,730	29,632,738	$ 0.77	$11,154	24,671,550	$ 0.45

	For the Six Months Ended June 30,					
	2018			2017		
($ in thousands except per share amounts)	Income (Numer-ator)	Shares (Denom-inator)	Per Share Amount	Income (Numer-ator)	Shares (Denom-inator)	Per Share Amount
Basic EPS						
Net income available to common shareholders	$43,403	29,539,308	$ 1.47	$18,709	23,288,635	$ 0.80
Effect of Dilutive Securities	—	91,514		—	79,868	
Diluted EPS per common share	$43,403	29,630,822	$ 1.46	$18,709	23,368,503	$ 0.80

For both the three and six months ended June 30, 2018 and 2017, there were no options that were antidilutive.

Index

Note 7 – Securities

The book values and approximate fair values of investment securities at June 30, 2018 and December 31, 2017 are summarized as follows:

($ in thousands)	June 30, 2018 Amortized Cost	Fair Value	Unrealized Gains	(Losses)	December 31, 2017 Amortized Cost	Fair Value	Unrealized Gains	(Losses)
Securities available for sale:								
Government-sponsored enterprise securities	$19,000	18,537	—	(463)	14,000	13,867	—	(133)
Mortgage-backed securities	292,809	282,287	48	(10,570)	297,690	295,213	246	(2,722)
Corporate bonds	33,772	33,244	64	(592)	33,792	34,190	512	(114)
Total available for sale	$345,581	334,068	112	(11,625)	345,482	343,270	758	(2,969)
Securities held to maturity:								
Mortgage-backed securities	$57,807	55,832	—	(1,975)	63,829	63,092	—	(737)
State and local governments	50,458	51,236	836	(58)	54,674	55,906	1,280	(48)
Total held to maturity	$108,265	107,068	836	(2,033)	118,503	118,998	1,280	(785)

All of the Company’s mortgage-backed securities, including commercial mortgage-backed obligations, were issued by government-sponsored corporations, except for two private mortgage-backed securities with a fair value of $1.1 million as of June 30, 2018.

The following table presents information regarding securities with unrealized losses at June 30, 2018:

($ in thousands)	Securities in an Unrealized Loss Position for Less than 12 Months		Securities in an Unrealized Loss Position for More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Government-sponsored enterprise securities	$15,615	385	2,922	78	18,537	463
Mortgage-backed securities	224,713	8,050	110,958	4,495	335,671	12,545
Corporate bonds	25,697	530	938	62	26,635	592
State and local governments	9,360	58	—	—	9,360	58
Total temporarily impaired securities	$275,385	9,023	114,818	4,635	390,203	13,658

The following table presents information regarding securities with unrealized losses at December 31, 2017:

($ in thousands)	Securities in an Unrealized Loss Position for Less than 12 Months		Securities in an Unrealized Loss Position for More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Government-sponsored enterprise securities	$10,897	103	2,970	30	13,867	133
Mortgage-backed securities	192,702	1,582	125,060	1,877	317,762	3,459
Corporate bonds	2,500	49	935	65	3,435	114
State and local governments	7,928	48	—	—	7,928	48
Total temporarily impaired securities	$214,027	1,782	128,965	1,972	342,992	3,754

In the above tables, all of the securities that were in an unrealized loss position at June 30, 2018 and December 31, 2017 were bonds that the Company has determined were in a loss position due primarily to interest rate factors and not credit quality concerns. The Company evaluated the collectability of each of these bonds and concluded that there was no other-than-temporary impairment. The Company does not intend to sell these securities, and it is more likely than not that the Company will not be required to sell these securities before recovery of the amortized cost.

Index

The book values and approximate fair values of investment securities at June 30, 2018, by contractual maturity, are summarized in the table below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

($ in thousands)	Securities Available for Sale		Securities Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Securities				
Due within one year	$—	—	3,248	3,276
Due after one year but within five years	40,227	39,324	28,348	28,815
Due after five years but within ten years	7,545	7,460	17,066	17,355
Due after ten years	5,000	4,997	1,796	1,790
Mortgage-backed securities	292,809	282,287	57,807	55,832
Total securities	$345,581	334,068	108,265	107,068

At June 30, 2018 and December 31, 2017, investment securities with carrying values of $233,437,000 and $176,813,000, respectively, were pledged as collateral for public deposits.

In the first six months of 2017, the Company received proceeds from sales of securities of $45,601,000 and recorded losses of $235,000 from the sales. There were no securities sales in the first six months of 2018.

Included in “other assets” in the consolidated balance sheets are cost method investments in Federal Home Loan Bank (“FHLB”) stock and Federal Reserve Bank of Richmond (“FRB”) stock totaling $37,437,000 and $31,338,000 at June 30, 2018 and December 31, 2017, respectively. The FHLB stock had a cost and fair value of $20,036,000 and $19,647,000 at June 30, 2018 and December 31, 2017, respectively, and serves as part of the collateral for the Company’s line of credit with the FHLB and is also a requirement for membership in the FHLB system. The FRB stock had a cost and fair value of $17,401,000 and $11,691,000 at June 30, 2018 and December 31, 2017, respectively, and is a requirement for FRB member bank qualification. Periodically, both the FHLB and FRB recalculate the Company’s required level of holdings, and the Company either buys more stock or redeems a portion of the stock at cost. The Company determined that neither stock was impaired at either period end.

Index

Note 8 – Loans and Asset Quality Information

On March 3, 2017, the Company acquired Carolina Bank (see Note 4 for more information). As a result of this acquisition, the Company recorded loans with a fair value of $497.5 million. Of those loans, $19.3 million were considered to be purchased credit impaired ("PCI") loans, which are loans for which it is probable at acquisition date that all contractually required payments will not be collected. The remaining loans are considered to be purchased non-impaired loans and their related fair value discount or premium is being recognized as an adjustment to yield over the remaining life of each loan.

The following table relates to Carolina Bank PCI loans and summarizes the contractually required payments, which includes principal and interest, expected cash flows to be collected, and the fair value of acquired PCI loans at the acquisition date.

($ in thousands)	Carolina Bank Acquisition on March 3, 2017
Contractually required payments	$ 27,108
Nonaccretable difference	(4,237)
Cash flows expected to be collected at acquisition	22,871
Accretable yield	(3,617)
Fair value of PCI loans at acquisition date	$ 19,254

The following table relates to acquired Carolina Bank purchased non-impaired loans and provides the contractually required payments, fair value, and estimate of contractual cash flows not expected to be collected at the acquisition date.

($ in thousands)	Carolina Bank Acquisition on March 3, 2017
Contractually required payments	$ 569,980
Fair value of acquired loans at acquisition date	478,515
Contractual cash flows not expected to be collected	3,650

On October 1, 2017, the Company acquired Asheville Savings Bank (see Note 4 for more information). As a result of this acquisition, the Company recorded loans with a fair value of $606.2 million. Of those loans, $9.9 million were considered to be PCI loans. The remaining loans were considered to be purchased non-impaired loans and their related fair value discount or premium is being recognized as an adjustment to yield over the remaining life of each loan.

The following table relates to acquired Asheville Savings Bank PCI loans and summarizes the contractually required payments, which includes principal and interest, expected cash flows to be collected, and the fair value of acquired PCI loans at the acquisition date.

($ in thousands)	Asheville Savings Bank Acquisition on October 1, 2017
Contractually required payments	$ 13,424
Nonaccretable difference	(1,734)
Cash flows expected to be collected at acquisition	11,690
Accretable yield	(1,804)
Fair value of PCI loans at acquisition date	$ 9,886

The following table relates to acquired Asheville Savings Bank purchased non-impaired loans and provides the contractually required payments, fair value, and estimate of contractual cash flows not expected to be collected at the acquisition date.

($ in thousands)	Asheville Savings Bank Acquisition on October 1, 2017
Contractually required payments	$ 727,706
Fair value of acquired loans at acquisition date	595,167
Contractual cash flows not expected to be collected	7,000

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

($ in thousands)	June 30, 2018		December 31, 2017		June 30, 2017	
	Amount	Percentage	Amount	Percentage	Amount	Percentage
All loans:						
Commercial, financial, and agricultural	$417,366	10%	$381,130	10%	$383,834	11%
Real estate – construction, land development & other land loans	600,031	14%	539,020	13%	446,661	13%
Real estate – mortgage – residential (1-4 family) first mortgages	1,000,189	24%	972,772	24%	783,759	23%
Real estate – mortgage – home equity loans / lines of credit	369,875	9%	379,978	9%	320,953	10%
Real estate – mortgage – commercial and other	1,690,175	41%	1,696,107	42%	1,384,569	41%
Installment loans to individuals	71,823	2%	74,348	2%	57,008	2%
Subtotal	4,149,459	100%	4,043,355	100%	3,376,784	100%
Unamortized net deferred loan fees	(69)		(986)		(808)	
Total loans	$4,149,390		$4,042,369		$3,375,976	

The following table presents changes in the carrying value of PCI loans.

($ in thousands)

	For the Six Months Ended June 30, 2018	For the Year Ended December 31, 2017
Purchased Credit Impaired Loans		
Balance at beginning of period	$23,165	514
Additions due to acquisition of Carolina Bank	—	19,254
Additions due to acquisition of Asheville Savings Bank	—	9,886
Change due to payments received and accretion	(2,328)	(6,016)
Change due to loan charge-offs	(10)	(12)
Transfers to foreclosed real estate	—	(69)
Other	5	(392)
Balance at end of period	$20,832	23,165

The following table presents changes in the accretable yield for PCI loans.

($ in thousands)

	For the Six Months Ended June 30, 2018	For the Year Ended December 31, 2017
Accretable Yield for PCI loans		
Balance at beginning of period	$ 4,688	—
Additions due to acquisition of Carolina Bank	—	3,617
Additions due to acquisition of Asheville Savings Bank	—	1,804
Accretion	(784)	(1,846)
Reclassification from (to) nonaccretable difference	206	423
Other, net	48	690
Balance at end of period	$ 4,158	4,688

During the first six months of 2018, the Company received $190,000 in payments that exceeded the carrying amount of the related PCI loans, of which $149,000 was recognized as loan discount accretion income and $41,000 was recorded as additional loan interest income. During the first six months of 2017, the Company received $564,000 in payments that exceeded the carrying amount of the related PCI loans, of which $558,000 was recognized as loan discount accretion income and $6,000 was recorded as additional loan interest income.

Index

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

($ in thousands)	June 30, 2018	December 31, 2017	June 30, 2017
Nonperforming assets			
Nonaccrual loans	$25,494	20,968	22,795
Restructured loans - accruing	17,386	19,834	21,019
Accruing loans > 90 days past due	—	—	—
Total nonperforming loans	42,880	40,802	43,814
Foreclosed real estate	8,296	12,571	11,196
Total nonperforming assets	$51,176	53,373	55,010
Purchased credit impaired loans not included above (1)	$20,832	23,165	16,846

(1) In the March 3, 2017 acquisition of Carolina Bank, and the October 1, 2017 acquisition of Asheville Savings Bank, the Company acquired $19.3 million and $9.9 million, respectively, in PCI loans in accordance with ASC 310-30 accounting guidance. These loans are excluded from nonperforming loans, including $0.5 million, $0.6 million, and $0.4 million in PCI loans at June 30, 2018, December 31, 2017, and June 30, 2017, respectively, that were contractually past due 90 days or more.

At June 30, 2018 and December 31, 2017, the Company had $0.4 million and $0.8 million, respectively, in residential mortgage loans in process of foreclosure.

The following is a summary of the Company's nonaccrual loans by major categories.

($ in thousands)	June 30, 2018	December 31, 2017
Commercial, financial, and agricultural	$3,407	1,001
Real estate – construction, land development & other land loans	1,374	1,822
Real estate – mortgage – residential (1-4 family) first mortgages	11,513	12,201
Real estate – mortgage – home equity loans / lines of credit	1,765	2,524
Real estate – mortgage – commercial and other	7,292	3,345
Installment loans to individuals	143	75
Total	$25,494	20,968

The following table presents an analysis of the payment status of the Company's loans as of June 30, 2018.

($ in thousands)	Accruing 30-59 Days Past Due	Accruing 60-89 Days Past Due	Accruing 90 Days or More Past Due	Nonaccrual Loans	Accruing Current	Total Loans Receivable
Commercial, financial, and agricultural	$ 1,398	28	—	3,407	412,264	417,097
Real estate – construction, land development & other land loans	913	276	—	1,374	597,143	599,706
Real estate – mortgage – residential (1-4 family) first mortgages	4,708	692	—	11,513	975,883	992,796
Real estate – mortgage – home equity loans / lines of credit	1,189	171	—	1,765	366,377	369,502
Real estate – mortgage – commercial and other	2,604	560	—	7,292	1,667,577	1,678,033
Installment loans to individuals	279	148	—	143	70,923	71,493
Purchased credit impaired	452	163	463	—	19,754	20,832
Total	$ 11,543	2,038	463	25,494	4,109,921	4,149,459
Unamortized net deferred loan fees						(69)
Total loans						$ 4,149,390

Page 22

Index

The following table presents an analysis of the payment status of the Company's loans as of December 31, 2017.

($ in thousands)	Accruing 30-59 Days Past Due	Accruing 60-89 Days Past Due	Accruing 90 Days or More Past Due	Nonaccrual Loans	Accruing Current	Total Loans Receivable
Commercial, financial, and agricultural	$ 89	151	—	1,001	379,241	380,482
Real estate – construction, land development & other land loans	1,154	214	—	1,822	535,423	538,613
Real estate – mortgage – residential (1-4 family) first mortgages	6,777	1,370	—	12,201	943,565	963,913
Real estate – mortgage – home equity loans / lines of credit	1,347	10	—	2,524	375,814	379,695
Real estate – mortgage – commercial and other	1,270	451	—	3,345	1,678,529	1,683,595
Installment loans to individuals	445	95	—	75	73,277	73,892
Purchased credit impaired	821	77	601	—	21,666	23,165
Total	$ 11,903	2,368	601	20,968	4,007,515	4,043,355
Unamortized net deferred loan fees						(986)
Total loans						$ 4,042,369

Page 23

Index

The following table presents the activity in the allowance for loan losses for all loans for the three and six months ended June 30, 2018.

($ in thousands)	Commercial, Financial, and Agricultural	Real Estate – Construction, Land Development & Other Land Loans	Real Estate – Residential (1-4 Family) First Mortgages	Real Estate – Mortgage – Home Equity Lines of Credit	Real Estate – Mortgage – Commercial and Other	Installment Loans to Individuals	Unallo -cated	Total
As of and for the three months ended June 30, 2018								
Beginning balance	$ 2,536	2,317	5,892	2,266	5,991	844	3,452	23,298
Charge-offs	(370)	(30)	(172)	(10)	(271)	(144)	—	(997)
Recoveries	313	341	371	90	542	50	—	1,707
Provisions	(211)	64	968	(96)	1,033	147	(2,615)	(710)
Ending balance	$ 2,268	2,692	7,059	2,250	7,295	897	837	23,298
As of and for the six months ended June 30, 2018								
Beginning balance	$ 3,111	2,816	6,147	1,827	6,475	950	1,972	23,298
Charge-offs	(609)	(32)	(415)	(186)	(312)	(262)	—	(1,816)
Recoveries	812	3,387	516	243	1,124	103	—	6,185
Provisions	(1,046)	(3,479)	811	366	8	106	(1,135)	(4,369)
Ending balance	$ 2,268	2,692	7,059	2,250	7,295	897	837	23,298
Ending balances as of June 30, 2018: Allowance for loan losses								
Individually evaluated for impairment	$ 277	302	2,756	415	1,231	6	—	4,987
Collectively evaluated for impairment	$ 1,991	2,390	4,133	1,794	6,052	891	837	18,088
Purchased credit impaired	$ —	—	170	41	12	—	—	223
Loans receivable as of June 30, 2018:								
Ending balance – total	$ 417,366	600,031	1,000,189	369,875	1,690,175	71,823	—	4,149,459
Unamortized net deferred loan fees								(69)
Total loans								$4,149,390

Ending balances as of June 30, 2018: Loans								
Individually evaluated for impairment	$ 3,208	3,549	15,247	671	10,333	10	—	33,018
Collectively evaluated for impairment	$ 413,889	596,157	977,549	368,831	1,667,700	71,483	—	4,095,609
Purchased credit impaired	$ 269	325	7,393	373	12,142	330	—	20,832

Page 24

Index

The following table presents the activity in the allowance for loan losses for the year ended December 31, 2017.

($ in thousands)	Commercial, Financial, and Agricultural	Real Estate – Construction, Land Development & Other Land Loans	Real Estate – Residential (1-4 Family) First Mortgages	Real Estate – Mortgage – Home Equity Lines of Credit	Real Estate – Mortgage – Commercial and Other	Installment Loans to Individuals	Unallo-cated	Total
As of and for the year ended December 31, 2017								
Beginning balance	$ 3,829	2,691	7,704	2,420	5,098	1,145	894	23,781
Charge-offs	(1,622)	(589)	(2,641)	(978)	(1,182)	(799)	—	(7,811)
Recoveries	1,311	2,579	1,076	333	1,027	279	—	6,605
Provisions	(407)	(1,865)	8	52	1,532	325	1,078	723
Ending balance	$ 3,111	2,816	6,147	1,827	6,475	950	1,972	23,298
Ending balances as of December 31, 2017: Allowance for loan losses								
Individually evaluated for impairment	$ 215	18	1,099	—	232	—	—	1,564
Collectively evaluated for impairment	$ 2,896	2,798	4,831	1,788	6,226	950	1,972	21,461
Purchased credit impaired	$ —	—	217	39	17	—	—	273
Loans receivable as of December 31, 2017:								
Ending balance – total	$ 381,130	539,020	972,772	379,978	1,696,107	74,348	—	4,043,355
Unamortized net deferred loan fees								(986)
Total loans								$ 4,042,369
Ending balances as of December 31, 2017: Loans								
Individually evaluated for impairment	$ 579	2,975	14,800	368	8,493	—	—	27,215
Collectively evaluated for impairment	$ 379,903	535,638	949,113	379,327	1,675,102	73,892	—	3,992,975
Purchased credit impaired	$ 648	407	8,859	283	12,512	456	—	23,165

Index

The following table presents the activity in the allowance for loan losses for all loans for the three and six months ended June 30, 2017.

($ in thousands)	Commercial, Financial, and Agricultural	Real Estate – Construction, Land Development & Other Land Loans	Real Estate – Residential (1-4 Family) First Mortgages	Real Estate – Mortgage – Home Equity Lines of Credit	Real Estate – Mortgage – Commercial and Other	Installment Loans to Individuals	Unallo-cated	Total
As of and for the three months ended June 30, 2017								
Beginning balance	$ 3,792	2,764	7,376	2,138	5,979	1,067	430	23,546
Charge-offs	(814)	(92)	(353)	(347)	(88)	(172)	—	(1,866)
Recoveries	220	981	440	65	555	84	—	2,345
Provisions	232	(977)	(378)	201	(293)	95	1,120	—
Ending balance	$ 3,430	2,676	7,085	2,057	6,153	1,074	1,550	24,025
As of and for the six months ended June 30, 2017								
Beginning balance	$ 3,829	2,691	7,704	2,420	5,098	1,145	894	23,781
Charge-offs	(1,204)	(269)	(1,247)	(578)	(414)	(359)	—	(4,071)
Recoveries	518	1,471	636	130	698	139	—	3,592
Provisions	287	(1,217)	(8)	85	771	149	656	723
Ending balance	$ 3,430	2,676	7,085	2,057	6,153	1,074	1,550	24,025
Ending balances as of June 30, 2017: Allowance for loan losses								
Individually evaluated for impairment	$ 8	182	1,304	—	424	—	—	1,918
Collectively evaluated for impairment	$ 3,422	2,494	5,781	2,057	5,729	1,074	1,550	22,107
Purchased credit impaired	$ —	—	—	—	—	—	—	—
Loans receivable as of June 30, 2017:								
Ending balance – total	$ 383,834	446,661	783,759	320,953	1,384,569	57,008	—	3,376,784
Unamortized net deferred loan fees								(808)
Total loans								$ 3,375,976
Ending balances as of June 30, 2017: Loans								
Individually evaluated for impairment	$ 235	3,250	17,083	54	9,053	—	—	29,675

Collectively evaluated for impairment	$ 383,330	442,956	763,224	320,174	1,363,629	56,950	—	3,330,263
Purchased credit impaired	$ 269	455	3,452	725	11,887	58	—	16,846

Page 26

Index

The following table presents loans individually evaluated for impairment by class of loans, excluding PCI loans, as of June 30, 2018.

($ in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment
Impaired loans with no related allowance recorded:				
Commercial, financial, and agricultural	$ 2,530	2,580	—	928
Real estate – mortgage – construction, land development & other land loans	2,948	3,429	—	2,901
Real estate – mortgage – residential (1-4 family) first mortgages	4,514	5,118	—	4,885
Real estate – mortgage –home equity loans / lines of credit	23	35	—	138
Real estate – mortgage –commercial and other	3,494	3,685	—	3,441
Installment loans to individuals	—	3	—	—
Total impaired loans with no allowance	$ 13,509	14,850	—	12,293
Impaired loans with an allowance recorded:				
Commercial, financial, and agricultural	$ 678	708	277	479
Real estate – mortgage – construction, land development & other land loans	601	723	302	355
Real estate – mortgage – residential (1-4 family) first mortgages	10,733	11,347	2,756	9,724
Real estate – mortgage –home equity loans / lines of credit	648	776	415	216
Real estate – mortgage –commercial and other	6,839	6,942	1,231	5,856
Installment loans to individuals	10	15	6	3
Total impaired loans with allowance	$ 19,509	20,511	4,987	16,633

Interest income recorded on impaired loans during the six months ended June 30, 2018 was insignificant.

The following table presents loans individually evaluated for impairment by class of loans, excluding PCI loans, as of December 31, 2017.

($ in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment
Impaired loans with no related allowance recorded:				
Commercial, financial, and agricultural	$ 183	425	—	276
Real estate – mortgage – construction, land development & other land loans	2,743	3,941	—	2,846
Real estate – mortgage – residential (1-4 family) first mortgages	5,205	5,728	—	7,067

Real estate – mortgage –home equity loans / lines of credit	368	387	—	129
Real estate – mortgage –commercial and other	3,066	3,321	—	3,143
Installment loans to individuals	—	—	—	—
Total impaired loans with no allowance	$ 11,565	13,802	—	13,461
Impaired loans with an allowance recorded:				
Commercial, financial, and agricultural	$ 396	396	215	214
Real estate – mortgage – construction, land development & other land loans	232	241	18	503
Real estate – mortgage – residential (1-4 family) first mortgages	9,595	9,829	1,099	10,077
Real estate – mortgage –home equity loans / lines of credit	—	—	—	66
Real estate – mortgage –commercial and other	5,427	5,427	232	5,369
Installment loans to individuals	—	—	—	—
Total impaired loans with allowance	$ 15,650	15,893	1,564	16,229

Interest income recorded on impaired loans during the year ended December 31, 2017 was insignificant.

Index

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

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

Risk Grade	Description
Pass:	
1	Loans with virtually no risk, including cash secured loans.
2	Loans with documented significant overall financial strength. These loans have minimum chance of loss due to the presence of multiple sources of repayment – each clearly sufficient to satisfy the obligation.
3	Loans with documented satisfactory overall financial strength. These loans have a low loss potential due to presence of at least two clearly identified sources of repayment – each of which is sufficient to satisfy the obligation under the present circumstances.
4	Loans to borrowers with acceptable financial condition. These loans could have signs of minor operational weaknesses, lack of adequate financial information, or loans supported by collateral with questionable value or marketability.
5	Loans that represent above average risk due to minor weaknesses and warrant closer scrutiny by management. Collateral is generally required and felt to provide reasonable coverage with realizable liquidation values in normal circumstances. Repayment performance is satisfactory.
P (Pass)	Consumer loans (<$500,000) that are of satisfactory credit quality with borrowers who exhibit good personal credit history, average personal financial strength and moderate debt levels. These loans generally conform to Bank policy, but may include approved mitigated exceptions to the guidelines.
Special Mention:	
6	Existing loans with defined weaknesses in primary source of repayment that, if not corrected, could cause a loss to the Bank.
Classified:	
7	An existing loan inadequately protected by the current sound net worth and paying capacity of the obligor or the collateral pledged, if any. These loans have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt.
8	Loans that have a well-defined weakness that make the collection or liquidation in full highly questionable and improbable. Loss appears imminent, but the exact amount and timing is uncertain.
9	Loans that are considered uncollectible and are in the process of being charged-off. This grade is a temporary grade assigned for administrative purposes until the charge-off is completed.
F (Fail)	Consumer loans (<$500,000) with a well-defined weakness, such as exceptions of any kind with no mitigating factors, history of paying outside the terms of the note, insufficient income to support the current level of debt, etc.

Index

The following table presents the Company's recorded investment in loans by credit quality indicators as of June 30, 2018.

($ in thousands)	Pass	Special Mention Loans	Classified Accruing Loans	Classified Nonaccrual Loans	Total
Commercial, financial, and agricultural	$410,434	2,322	934	3,407	417,097
Real estate – construction, land development & other land loans	586,310	6,812	5,210	1,374	599,706
Real estate – mortgage – residential (1-4 family) first mortgages	941,399	13,829	26,055	11,513	992,796
Real estate – mortgage – home equity loans / lines of credit	357,507	1,698	8,532	1,765	369,502
Real estate – mortgage – commercial and other	1,648,367	16,644	5,730	7,292	1,678,033
Installment loans to individuals	70,776	215	359	143	71,493
Purchased credit impaired	6,376	7,059	7,397	—	20,832
Total	$4,021,169	48,579	54,217	25,494	4,149,459
Unamortized net deferred loan fees					(69)
Total loans					4,149,390

The following table presents the Company's recorded investment in loans by credit quality indicators as of December 31, 2017.

($ in thousands)	Pass	Special Mention Loans	Classified Accruing Loans	Classified Nonaccrual Loans	Total
Commercial, financial, and agricultural	$368,658	9,901	922	1,001	380,482
Real estate – construction, land development & other land loans	523,642	7,129	6,020	1,822	538,613
Real estate – mortgage – residential (1-4 family) first mortgages	905,111	16,235	30,366	12,201	963,913
Real estate – mortgage – home equity loans / lines of credit	365,982	3,784	7,405	2,524	379,695
Real estate – mortgage – commercial and other	1,647,725	23,335	9,190	3,345	1,683,595
Installment loans to individuals	73,379	222	216	75	73,892
Purchased credit impaired	6,541	12,309	4,315	—	23,165
Total	$3,891,038	72,915	58,434	20,968	4,043,355
Unamortized net deferred loan fees					(986)
Total loans					4,042,369

Troubled Debt Restructurings

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

The vast majority of the Company’s troubled debt restructurings modified related to interest rate reductions combined with restructured amortization schedules. The Company does not generally grant principal forgiveness.

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

Index

The following table presents information related to loans modified in a troubled debt restructuring during the three months ended June 30, 2018 and 2017.

($ in thousands)	For three months ended June 30, 2018			For the three months ended June 30, 2017		
	Number of Contracts	Pre-Modification Restructured Balances	Post-Modification Restructured Balances	Number of Contracts	Pre-Modification Restructured Balances	Post-Modification Restructured Balances
TDRs – Accruing						
Commercial, financial, and agricultural	—	$ —	$ —	—	$ —	$ —
Real estate – construction, land development & other land loans	—	—	—	—	—	—
Real estate – mortgage – residential (1-4 family) first mortgages	1	18	18	—	—	—
Real estate – mortgage – home equity loans / lines of credit	—	—	—	—	—	—
Real estate – mortgage – commercial and other	—	—	—	3	1,000	1,000
Installment loans to individuals	—	—	—	—	—	—
TDRs – Nonaccrual						
Commercial, financial, and agricultural	—	—	—	1	38	25
Real estate – construction, land development & other land loans	—	—	—	1	32	32
Real estate – mortgage – residential (1-4 family) first mortgages	—	—	—	1	215	215
Real estate – mortgage – home equity loans / lines of credit	—	—	—	—	—	—
Real estate – mortgage – commercial and other	—	—	—	—	—	—
Installment loans to individuals	—	—	—	—	—	—
Total TDRs arising during period	1	$ 18	$ 18	6	$ 1,285	$ 1,272

Page 30

Index

The following table presents information related to loans modified in a troubled debt restructuring during the six months ended June 30, 2018 and 2017.

($ in thousands)	For six months ended June 30, 2018			For the six months ended June 30, 2017		
	Number of Contracts	Pre-Modification Restructured Balances	Post-Modification Restructured Balances	Number of Contracts	Pre-Modification Restructured Balances	Post-Modification Restructured Balances
TDRs – Accruing						
Commercial, financial, and agricultural	—	$ —	$ —	—	$ —	$ —
Real estate – construction, land development & other land loans	—	—	—	—	—	—
Real estate – mortgage – residential (1-4 family) first mortgages	1	18	18	—	—	—
Real estate – mortgage – home equity loans / lines of credit	—	—	—	—	—	—
Real estate – mortgage – commercial and other	—	—	—	5	3,550	3,525
Installment loans to individuals	—	—	—	—	—	—
TDRs – Nonaccrual						
Commercial, financial, and agricultural	—	—	—	1	38	25
Real estate – construction, land development & other land loans	1	61	61	1	32	32
Real estate – mortgage – residential (1-4 family) first mortgages	2	254	264	1	215	215
Real estate – mortgage – home equity loans / lines of credit	—	—	—	—	—	—
Real estate – mortgage – commercial and other	—	—	—	—	—	—
Installment loans to individuals	—	—	—	—	—	—
Total TDRs arising during period	4	$ 333	$ 343	8	$ 3,835	$ 3,797

Accruing restructured loans that were modified in the previous 12 months and that defaulted during the three months ended June 30, 2018 and 2017 are presented in the table below. The Company considers a loan to have defaulted when it becomes 90 or more days delinquent under the modified terms, has been transferred to nonaccrual status, or has been transferred to foreclosed real estate.

($ in thousands)	For the three months ended June 30, 2018		For the three months ended June 30, 2017	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
Accruing TDRs that subsequently defaulted				

Real estate – mortgage – residential (1-4 family first mortgages)	1	$ 60	1	$ 254
Real estate – mortgage – commercial and other	2	763	—	—
Total accruing TDRs that subsequently defaulted	3	$ 823	1	$ 254

Accruing restructured loans that were modified in the previous 12 months and that defaulted during the six months ended June 30, 2018 and 2017 are presented in the table below

($ in thousands)	For the six months ended June 30, 2018		For the six months ended June 30, 2017	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
Accruing TDRs that subsequently defaulted				
Real estate – mortgage – residential (1-4 family first mortgages)	1	$ 60	2	$ 880
Real estate – mortgage – commercial and other	3	1,333	—	—
Total accruing TDRs that subsequently defaulted	4	$ 1,393	2	$ 880

Index

Note 9 – Deferred Loan (Fees) Costs

The amount of loans shown on the consolidated balance sheets includes net deferred loan (fees) costs of approximately ($69,000), ($986,000), and ($808,000) at June 30, 2018, December 31, 2017, and June 30, 2017, respectively.

Note 10 – Goodwill and Other Intangible Assets

The following is a summary of the gross carrying amount and accumulated amortization of amortizable intangible assets as of June 30, 2018, December 31, 2017, and June 30, 2017 and the carrying amount of unamortized intangible assets as of those same dates.

	June 30, 2018		December 31, 2017		June 30, 2017	
($ in thousands)	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortizable intangible assets:						
Customer lists	$6,013	1,322	6,013	1,090	2,369	866
Core deposit intangibles	28,440	14,078	28,280	11,475	18,520	9,404
SBA servicing asset	4,166	558	2,194	207	928	66
Other	1,303	812	1,303	581	1,032	381
Total	$39,922	16,770	37,790	13,353	22,849	10,717
Unamortizable intangible assets:						
Goodwill	$232,458		233,070		139,124	

Activity related to transactions during the periods includes the following:

(1) In connection with the Carolina Bank acquisition on March 3, 2017, the Company recorded a net increase of $65,072,000 in goodwill and $8,790,000 in a core deposit intangible.

(2) In connection with the September 1, 2017 acquisition of Bear Insurance Service, the Company recorded $5,330,000 in goodwill, $3,644,000 in a customer list intangible, and $271,000 in other amortizable intangible assets.

(3) In connection with the Asheville Savings Bank acquisition on October 1, 2017, the Company recorded a net increase of $88,235,000 in goodwill and $9,880,000 in a core deposit intangible.

In addition to the above acquisition related activity, the Company recorded $1,972,000 and $513,000 in servicing assets associated with the guaranteed portion of SBA loans originated and sold during the first six months of 2018 and 2017, respectively. During the first six months of 2018 and 2017, the Company recorded $351,000 and $66,000, respectively, in related amortization expense. Servicing assets are recorded at fair value and amortized over the expected life of the related loans.

Amortization expense of all intangible assets totaled $1,745,000 and $1,031,000 for the three months ended June 30, 2018 and 2017, respectively, and $3,417,000 and $1,607,000 for the six months ended June 30, 2018 and 2017, respectively.

The following table presents the estimated amortization expense related to amortizable intangible assets for the last two quarters of calendar year 2018 and for each of the four calendar years ending December 31, 2022 and the estimated amount amortizable thereafter. These estimates are subject to change in future periods to the extent management determines it is necessary to make adjustments to the carrying value or estimated useful lives of amortized intangible assets.

($ in thousands)	Estimated Amortization Expense
July 1 to December 31, 2018	$ 3,164
2019	5,440
2020	4,370
2021	3,288
2022	2,312
Thereafter	4,578
Total	$ 23,152

Index

Note 11 – Pension Plans

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

The Company recorded periodic pension cost (income) totaling ($93,000) and ($241,000) for the three months ended June 30, 2018 and 2017, respectively, which primarily related to investment income from the Pension Plan’s assets. The following table contains the components of the pension cost (income).

	For the Three Months Ended June 30,					
($ in thousands)	2018 Pension Plan	2017 Pension Plan	2018 SERP	2017 SERP	2018 Total Both Plans	2017 Total Both Plans
Service cost	$—	—	33	32	33	32
Interest cost	326	350	53	53	379	403
Expected return on plan assets	(556)	(730)	—	—	(556)	(730)
Amortization of net (gain)/loss	59	62	(8)	(8)	51	54
Net periodic pension cost (income)	$(171)	(318)	78	77	(93)	(241)

The Company recorded pension cost (income) totaling $272,000 and $(403,000) for the six months ended June 30, 2018 and 2017, respectively. The following table contains the components of the pension cost (income).

	For the Six Months Ended June 30,					
($ in thousands)	2018 Pension Plan	2017 Pension Plan	2018 SERP	2017 SERP	2018 Total Both Plans	2017 Total Both Plans
Service cost	$—	—	62	59	62	59
Interest cost	656	725	110	113	766	838
Expected return on plan assets	(659)	(1,405)	—	—	(659)	(1,405)
Amortization of net (gain)/loss	119	122	(16)	(17)	103	105
Net periodic pension cost (income)	$116	(558)	156	155	272	(403)

The service cost component of net periodic pension cost (income) is included in salaries and benefits expense and all other components of net periodic pension cost (income) are included in other noninterest expense.

The Company's contributions to the Pension Plan are based on computations by independent actuarial consultants and are intended to be deductible for income tax purposes. The Company does not expect to contribute to the Pension Plan in 2018.

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

Note 12 – Comprehensive Income (Loss)

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

($ in thousands)	June 30, 2018	December 31, 2017	June 30, 2017
Unrealized gain (loss) on securities available for sale	$(11,513)	(2,211)	252
Deferred tax asset (liability)	2,691	517	(93)
Net unrealized gain (loss) on securities available for sale	(8,822)	(1,694)	159
Additional pension asset (liability)	(3,097)	(3,200)	(4,907)
Deferred tax asset (liability)	724	748	1,816
Net additional pension asset (liability)	(2,373)	(2,452)	(3,091)
Total accumulated other comprehensive income (loss)	$(11,195)	(4,146)	(2,932)

Index

The following table discloses the changes in accumulated other comprehensive income (loss) for the six months ended June 30, 2018 (all amounts are net of tax).

($ in thousands)	Unrealized Gain (Loss) on Securities Available for Sale	Additional Pension Asset (Liability)	Total
Beginning balance at January 1, 2018	$ (1,694)	(2,452)	(4,146)
Other comprehensive income (loss) before reclassifications	(7,128)	—	(7,128)
Amounts reclassified from accumulated other comprehensive income	—	79	79
Net current-period other comprehensive income (loss)	(7,128)	79	(7,049)
Ending balance at June 30, 2018	$ (8,822)	(2,373)	(11,195)

The following table discloses the changes in accumulated other comprehensive income (loss) for the six months ended June 30, 2017 (all amounts are net of tax).

($ in thousands)	Unrealized Gain (Loss) on Securities Available for Sale	Additional Pension Asset (Liability)	Total
Beginning balance at January 1, 2017	$ (1,947)	(3,160)	(5,107)
Other comprehensive income (loss) before reclassifications	1,958	—	1,958
Amounts reclassified from accumulated other comprehensive income	148	69	217
Net current-period other comprehensive income (loss)	2,106	69	2,175
Ending balance at June 30, 2017	$ 159	(3,091)	(2,932)

Note 13 – Fair Value

Relevant accounting guidance establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) of identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity’s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Index

The following table summarizes the Company's financial instruments that were measured at fair value on a recurring and nonrecurring basis at June 30, 2018.

($ in thousands)

Description of Financial Instruments	Fair Value at June 30, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Recurring				
Securities available for sale:				
Government-sponsored enterprise securities	$18,537	—	18,537	—
Mortgage-backed securities	282,287	—	282,287	—
Corporate bonds	33,244	—	33,244	—
Total available for sale securities	$334,068	—	334,068	—
Nonrecurring				
Impaired loans	$14,586	—	—	14,586
Foreclosed real estate	8,296	—	—	8,296

The following table summarizes the Company's financial instruments that were measured at fair value on a recurring and nonrecurring basis at December 31, 2017.

($ in thousands)

Description of Financial Instruments	Fair Value at December 31, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Recurring				
Securities available for sale:				
Government-sponsored enterprise securities	$13,867	—	13,867	—
Mortgage-backed securities	295,213	—	295,213	—
Corporate bonds	34,190	—	34,190	—
Total available for sale securities	$343,270	—	343,270	—
Nonrecurring				
Impaired loans	$14,086	—	—	14,086

Foreclosed real estate	12,571	—	—	12,571

The following is a description of the valuation methodologies used for instruments measured at fair value.

Securities Available for Sale — When quoted market prices are available in an active market, the securities are classified as Level 1 in the valuation hierarchy. If quoted market prices are not available, but fair values can be estimated by observing quoted prices of securities with similar characteristics, the securities are classified as Level 2 on the valuation hierarchy. Most of the fair values for the Company’s Level 2 securities are determined by our third-party bond accounting provider using matrix pricing. Matrix pricing is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities’ relationship to other benchmark quoted securities. For the Company, Level 2 securities include mortgage-backed securities, collateralized mortgage obligations, government-sponsored enterprise securities, and corporate bonds. In cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

The Company reviews the pricing methodologies utilized by the bond accounting provider to ensure the fair value determination is consistent with the applicable accounting guidance and that the investments are properly classified in the fair value hierarchy. Further, the Company validates the fair values for a sample of securities in the portfolio by comparing the fair values provided by the bond accounting provider to prices from other independent sources for the same or similar securities. The Company analyzes unusual or significant variances and conducts additional research with the portfolio manager, if necessary, and takes appropriate action based on its findings.

Index

Impaired loans — Fair values for impaired loans in the above table are measured on a non-recurring basis and are based on the underlying collateral values securing the loans, adjusted for estimated selling costs, or the net present value of the cash flows expected to be received for such loans. Collateral may be in the form of real estate or business assets including equipment, inventory and accounts receivable. The vast majority of the collateral is real estate. The value of real estate collateral is determined using an income or market valuation approach based on an appraisal conducted by an independent, licensed third party appraiser (Level 3). The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable borrower's financial statements if not considered significant. Likewise, values for inventory and accounts receivable collateral are based on borrower financial statement balances or aging reports on a discounted basis as appropriate (Level 3). Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income.

Foreclosed real estate – Foreclosed real estate, consisting of properties obtained through foreclosure or in satisfaction of loans, is reported at the lower of cost or fair value. Fair value is measured on a non-recurring basis and is based upon independent market prices or current appraisals that are generally prepared using an income or market valuation approach and conducted by an independent, licensed third party appraiser, adjusted for estimated selling costs (Level 3). At the time of foreclosure, any excess of the loan balance over the fair value of the real estate held as collateral is treated as a charge against the allowance for loan losses. For any real estate valuations subsequent to foreclosure, any excess of the real estate recorded value over the fair value of the real estate is treated as a foreclosed real estate write-down on the Consolidated Statements of Income.

For Level 3 assets and liabilities measured at fair value on a recurring or non-recurring basis as of June 30, 2018, the significant unobservable inputs used in the fair value measurements were as follows:

($ in thousands)

Description	Fair Value at June 30, 2018		Valuation Technique	Significant Unobservable Inputs	General Range of Significant Unobservable Input Values
Impaired loans	$	14,586	Appraised value; PV of expected cash flows	Discounts to reflect current market conditions, ultimate collectability, and estimated costs to sell	0-10%
Foreclosed real estate	8,296		Appraised value; List or contract price	Discounts to reflect current market conditions, abbreviated holding period and estimated costs to sell	0-10%

For Level 3 assets and liabilities measured at fair value on a recurring or non-recurring basis as of December 31, 2017, the significant unobservable inputs used in the fair value measurements were as follows:

($ in thousands)

Description	Fair Value at December 31, 2017	Valuation Technique	Significant Unobservable Inputs	General Range of Significant Unobservable Input Values
Impaired loans	$ 14,086	Appraised value; PV of expected cash flows	Discounts to reflect current market conditions, ultimate collectability, and estimated costs to sell	0-10%
Foreclosed real estate	12,571	Appraised value; List or contract price	Discounts to reflect current market conditions and estimated costs to sell	0-10%

Transfers of assets or liabilities between levels within the fair value hierarchy are recognized when an event or change in circumstances occurs. There were no transfers between Level 1 and Level 2 for assets or liabilities measured on a recurring basis during the six months ended June 30, 2018 or 2017.

For the six months ended June 30, 2018 and 2017, the increase (decrease) in the fair value of securities available for sale was ($9,302,000) and $3,102,000, respectively, which is included in other comprehensive income (net of tax benefit (expense) of $2,174,000 and ($1,144,000), respectively). Fair value measurement methods at June 30, 2018 and 2017 are consistent with those used in prior reporting periods.

Index

The carrying amounts and estimated fair values of financial instruments at June 30, 2018 and December 31, 2017 are as follows:

($ in thousands)	Level in Fair Value Hierarchy	June 30, 2018 Carrying Amount	June 30, 2018 Estimated Fair Value	December 31, 2017 Carrying Amount	December 31, 2017 Estimated Fair Value
Cash and due from banks, noninterest-bearing	Level 1	$97,163	97,163	114,301	114,301
Due from banks, interest-bearing	Level 1	462,972	462,972	375,189	375,189
Securities available for sale	Level 2	334,068	334,068	343,270	343,270
Securities held to maturity	Level 2	108,265	107,068	118,503	118,998
Presold mortgages in process of settlement	Level 1	9,311	9,311	12,459	12,459
Total loans, net of allowance	Level 3	4,126,092	4,084,898	4,019,071	4,010,551
Accrued interest receivable	Level 1	13,930	13,930	14,094	14,094
Bank-owned life insurance	Level 1	100,413	100,413	99,162	99,162
Deposits	Level 2	4,553,621	4,547,235	4,406,955	4,401,757
Borrowings	Level 2	407,076	398,113	407,543	397,903
Accrued interest payable	Level 2	1,651	1,651	1,235	1,235

Fair value methods and assumptions are set forth below for the Company’s financial instruments.

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

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

Loans - For nonimpaired loans, fair values are determined assuming the sale of the notes to a third-party financial investor. Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, financial and agricultural, real estate construction, real estate mortgages and installment loans to individuals. Each loan category is further segmented into fixed and variable interest rate terms. The fair value for each category is determined by discounting scheduled future cash flows using current interest rates with a liquidity discount offered on loans with similar risk characteristics, and includes the Company’s estimate of future credit losses expected to be incurred over the life of the loan. Fair values for impaired loans are primarily based on estimated proceeds expected upon liquidation of the collateral or the present value of expected cash flows.

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

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

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

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

Index

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

Note 14 – Revenue from Contracts with Customers

All of the Company's revenues that are in the scope of the "*Revenue from Contracts with Customers*" accounting standard ("ASC 606") are recognized within noninterest income. The following table presents the Company's sources of noninterest income for the six months ended June, 2018 and 2017. Items outside the scope of ASC 606 are noted as such.

$ in thousands	For the Six Months Ended June 30, 2018	June 30, 2017
Service charges on deposit accounts	$6,385	5,580
Other service charges, commissions, and fees:		
Interchange income	6,543	4,697
Other fees	2,967	2,030
Fees from presold mortgage loans (1)	1,655	2,279
Commissions from sales of insurance and financial products:		
Insurance income	2,903	858
Wealth management income	1,156	1,020
SBA consulting fees	2,267	2,310
SBA loan sale gains (1)	6,400	1,549
Bank-owned life insurance income (1)	1,251	1,088
Foreclosed property gains (losses), net	(387)	(223)
Securities gains (losses), net (1)	—	(235)
Other gains (losses), net (1)	912	731
Total noninterest income	$32,052	21,684

(1) Not within the scope of ASC 606.

A description of the Company's revenue streams accounted for under ASC 606 is detailed below.

Service Charges on Deposit Accounts: The Company earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Overdraft fees are recognized at the point in time that the overdraft occurs. Maintenance and activity fees include account maintenance fees and transaction-based fees. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of the month, representing the period over which the Company satisfies the performance obligation. Transaction-based fees, which include services such as ATM use fees, stop payment charges, statement rendering, are recognized at the time the transaction is executed as that is the point in time the Company fulfills the customer's request. Service charges on deposits are withdrawn from the customer's account balance.

Other service charges, commissions, and fees: The Company earns interchange income on its customers' debit and credit card usage and earns fees from other services utilized by its customers. Interchange income is primarily comprised of interchange fees earned whenever the Company's debit and credit cards are processed through card payment networks such as Mastercard. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder. Other service charges include revenue from processing wire transfers, bill pay service, cashier's checks, ATM surcharge fees, and other services. The Company's performance obligation for fees, exchange, and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month.

Index

Commissions from the sale of insurance and financial products: The Company earns commissions from the sale of insurance policies and wealth management products.

Insurance income generally consists of commissions from the sale of insurance policies and performance-based commissions from insurance companies. The Company recognizes commission income from the sale of insurance policies when it acts as an agent between the insurance company and the policyholder. The Company’s performance obligation is generally satisfied upon the issuance of the insurance policy. Shortly after the policy is issued, the carrier remits the commission payment to the Company, and the Company recognizes the revenue. Performance-based commissions from insurance companies are recognized at a point in time as policies are sold.

Wealth Management Income primarily consists of commissions received on financial product sales, such as annuities. The Company’s performance obligation is generally satisfied upon the issuance of the financial product. Shortly after the policy is issued, the carrier remits the commission payment to the Company, and the Company recognizes the revenue. The Company also earns some fees from asset management, which is billed quarterly for services rendered in the most recent period, for which the performance obligation has been satisfied.

SBA Consulting fees: The Company earns fees for its consulting services related to the origination of SBA loans. Fees are based on a percentage of the dollar amount of the originated loans and are recorded when the performance obligation has been satisfied.

Foreclosed property gains (losses), net: The Company records a gain or loss from the sale of foreclosed property when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Company finances the sale of foreclosed property to the buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the foreclosed property asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer.

The Company has made no significant judgments in applying the revenue guidance prescribed in ASC 606 that affect the determination of the amount and timing of revenue from the above-described contracts with customers.

Index

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

Critical Accounting Policies

The accounting principles we follow and our methods of applying these principles conform with accounting principles generally accepted in the United States of America and with general practices followed by the banking industry. Certain of these principles involve a significant amount of judgment and may involve the use of estimates based on our best assumptions at the time of the estimation. The allowance for loan losses, intangible assets, and the fair value and discount accretion of acquired loans are three policies we have identified as being more sensitive in terms of judgments and estimates, taking into account their overall potential impact to our consolidated financial statements.

Allowance for Loan Losses

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

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

The second component of the allowance model is an estimate of losses for all loans not considered to be impaired loans ("general reserve loans"). General reserve loans are segregated into pools by loan type and risk grade and estimated loss percentages are assigned to each loan pool based on historical losses. The historical loss percentages are then adjusted for any environmental factors used to reflect changes in the collectability of the portfolio not captured by historical data.

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

Purchased loans are recorded at fair value at the acquisition date. Therefore, amounts deemed uncollectible at the acquisition date represent a discount to the loan value and become a part of the fair value calculation. Subsequent decreases in the amount expected to be collected result in a provision for loan losses with a corresponding increase in the allowance for loan losses. Subsequent increases in the amount expected to be collected are accreted into income over the life of the loan and this accretion is referred to as “loan discount accretion.”

Within the purchased loan portfolio, loans are deemed purchased credit impaired at acquisition if the bank believes it will not be able to collect all contractual cash flows. Performing loans with an unamortized discount or premium that are not deemed purchased credit impaired are considered to be purchased performing loans. Purchased credit impaired loans are individually evaluated as impaired loans, as described above, while purchased performing loans are evaluated as general reserve loans. For purchased performing loan pools, any computed allowance that is in excess of remaining net discounts is a component of the allocated allowance.

Index

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

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

Intangible Assets

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

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

The primary identifiable intangible asset we typically record in connection with a whole bank or bank branch acquisition is the value of the core deposit intangible, whereas when we acquire an insurance agency or a consulting firm, as we did in 2016 and 2017, the primary identifiable intangible asset is the value of the acquired customer list. Determining the amount of identifiable intangible assets and their average lives involves multiple assumptions and estimates and is typically determined by performing a discounted cash flow analysis, which involves a combination of any or all of the following assumptions: customer attrition/runoff, alternative funding costs, deposit servicing costs, and discount rates. We typically engage a third party consultant to assist in each analysis. For the whole bank and bank branch transactions recorded to date, the core deposit intangibles have generally been estimated to have a life ranging from seven to ten years, with an accelerated rate of amortization. For insurance agency acquisitions, the identifiable intangible assets related to the customer lists were determined to have a life of ten to fifteen years, with amortization occurring on a straight-line basis. For the SBA consulting firm we acquired in 2016, the identifiable intangible asset related to the customer list was determined to have a life of approximately seven years, with amortization occurring on a straight-line basis.

Subsequent to the initial recording of the identifiable intangible assets and goodwill, we amortize the identifiable intangible assets over their estimated average lives, as discussed above. In addition, on at least an annual basis, goodwill is evaluated for impairment by comparing the fair value of our reporting units to their related carrying value, including goodwill. We have three reporting units – 1) First Bank with $220.8 million in goodwill, 2) First Bank Insurance with $7.4 million in goodwill, and 3) SBA activities, including SBA Complete and our SBA lending division, with $4.3 million in goodwill. If the carrying value of a reporting unit were ever to exceed its fair value, we would determine whether the implied fair value of the goodwill, using a discounted cash flow analysis, exceeded the carrying value of the goodwill. If the carrying value of the goodwill exceeded the implied fair value of the goodwill, an impairment loss would be recorded in an amount equal to that excess. Performing such a discounted cash flow analysis would involve the significant use of estimates and assumptions.

In our 2017 goodwill impairment evaluation, we concluded that the goodwill for each of our reporting units was not impaired.

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

Index

Fair Value and Discount Accretion of Acquired Loans

We consider the determination of the initial fair value of acquired loans and the subsequent discount accretion of the purchased loans to involve a high degree of judgment and complexity.

We determine fair value accounting estimates of newly assumed assets and liabilities in accordance with relevant accounting guidance. However, the amount that we realize on these assets could differ materially from the carrying value reflected in our financial statements, based upon the timing of collections on the acquired loans in future periods. Because of inherent credit losses and interest rate marks associated with acquired loans, the amount that we record as the fair values for the loans is generally less than the contractual unpaid principal balance due from the borrowers, with the difference being referred to as the "discount" on the acquired loans. For non-impaired purchased loans, we accrete the discount over the lives of the loans in a manner consistent with the guidance for accounting for loan origination fees and costs.

For purchased credit-impaired ("PCI") loans, the excess of the cash flows initially expected to be collected over the fair value of the loans at the acquisition date (i.e., the accretable yield) is accreted into interest income over the estimated remaining life of the loans using the effective yield method, provided that the timing and the amount of future cash flows is reasonably estimable. Accordingly, such loans are not classified as nonaccrual and they are considered to be accruing because their interest income relates to the accretable yield recognized under accounting for PCI loans and not to contractual interest payments. The difference between the contractually required payments and the cash flows expected to be collected at acquisition, considering the impact of prepayments, is referred to as the nonaccretable difference.

Subsequent to an acquisition, estimates of cash flows expected to be collected are updated periodically based on updated assumptions regarding default rates, loss severities, and other factors that are reflective of current market conditions. If there is a decrease in cash flows expected to be collected, the provision for loan losses is charged, resulting in an increase to the allowance for loan losses. If the Company has a probable increase in cash flows expected to be collected, we will first reverse any previously established allowance for loan losses and then increase interest income as a prospective yield adjustment over the remaining life of the loan. The impact of changes in variable interest rates is recognized prospectively as adjustments to interest income.

Current Accounting Matters

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

FINANCIAL OVERVIEW

Net income available to common shareholders amounted to $22.7 million, or $0.77 per diluted common share, for the three months ended June 30, 2018, an increase of 71.1% in earnings per share from the $11.2 million, or $0.45 per diluted common share, recorded in the second quarter of 2017.

For the six months ended June 30, 2018, we recorded net income available to common shareholders of $43.4 million, or $1.46 per diluted common share, an increase of 82.5% in earnings per share from the $18.7 million, or $0.80 per diluted common share, for the six months ended June 30, 2017.

Comparisons for the financial periods presented were significantly impacted by our acquisitions of Carolina Bank in March 2017 with total assets of $684 million and Asheville Savings Bank in October 2017 with $798 million in total assets. The assets, liabilities and earnings for these acquisitions were recorded beginning on their respective acquisition dates.

Net Interest Income and Net Interest Margin

Net interest income for the second quarter of 2018 was $51.2 million, a 28.3% increase from the $39.9 million recorded in the second quarter of 2017. Net interest income for the first six months of 2018 amounted to $101.7 million, a 37.1% increase from the $74.2 million recorded in the comparable period of 2017. The increase in net interest income was primarily due to the acquisitions of Carolina Bank and Asheville Savings Bank, as well as higher amounts of loans outstanding as a result of organic growth.

Index

Our net interest margin (tax-equivalent net interest income divided by average earning assets) for the second quarter of 2018 was 4.10% compared to 4.08% for the second quarter of 2017. For the six month period ended June 30, 2018, our net interest margin was 4.15% compared to 4.08% for the same period in 2017. Asset yields increased primarily as a result of five Federal Reserve interest rate increases since January 1, 2017. Funding costs also increased, but to a lesser degree. Also positively impacting interest income in 2018 was approximately $750,000 in interest recoveries received in the first quarter of the year, which primarily related to the same loans that experienced significant allowance for loan loss recoveries discussed below in "Provisions for Loan Losses and Asset Quality."

The net interest margins for the periods were also impacted by loan discount accretion associated with acquired loan portfolios. We recorded loan discount accretion amounting to $2.3 million in the second quarter of 2018, compared to $2.0 million in the second quarter of 2017. For the first six months of 2018 and 2017, loan discount accretion amounted to $4.4 million and $3.3 million, respectively. The increase in loan discount accretion in 2018 was primarily due to the loan discounts recorded in the acquisitions of Carolina Bank and Asheville Savings Bank.

Provision for Loan Losses and Asset Quality

We recorded a negative provision for loan losses (reduction of the allowance for loan losses) of $0.7 million in the second quarter of 2018, compared to no provision for loan losses in the second quarter of 2017. For the six months ended June 30, 2018, we recorded a total negative provision for loan losses of $4.4 million compared to a total provision for loan losses of $0.7 million in the same period of 2017.

During the first half of 2018, we experienced net loan recoveries of $4.4 million, including full payoffs received on four loans in the first quarter of 2018 that had been previously charged-down by approximately $3.3 million. The amounts received in excess of the prior charge-downs were recorded as interest income recoveries, and those four loans were primarily responsible for the $750,000 in interest recoveries previously noted.

Our provision for loan losses have also been impacted by continued improvement in asset quality. Our nonperforming assets to total assets ratio was 0.90% at June 30, 2018 compared to 1.21% at June 30, 2017. The ratio of annualized net charge-offs (recoveries) to average loans for the six months ended June 30, 2018 was (0.21%), compared to 0.03% for the same period of 2017.

Noninterest Income

Total noninterest income was $16.1 million and $11.9 million for the three months ended June 30, 2018 and June 30, 2017, respectively. For the six months ended June 30, 2018, noninterest income amounted to $32.1 million compared to $21.7 million for the same period of 2017.

Core noninterest income for the second quarter of 2018 was $15.3 million, an increase of 31.6% from the $11.6 million reported for the second quarter of 2017. For the first six months of 2018, core noninterest income amounted to $31.5 million, a 47.2% increase from the $21.4 million recorded in the comparable period of 2017. Core noninterest income includes i) service charges on deposit accounts, ii) other service charges, commissions, and fees, iii) fees from presold mortgage loans, iv) commissions from sales of insurance and financial products, v) SBA consulting fees, vi) SBA loan sale gains, and vii) bank-owned life insurance income.

The primary reason for the increase in core noninterest income in 2018 was an increase in SBA loan sales volume. During the three and six months ended June 30, 2018, we realized $2.6 million and $6.4 million in gains on SBA loan sales, respectively. In comparison, during the three and six months ended June 30, 2017, we realized $0.9 million and $1.5 million in gains on SBA loan sales, respectively. Also contributing to the increase in core noninterest income in 2018 were the acquisitions of Carolina Bank and Asheville Savings Bank.

Noninterest Expenses

Noninterest expenses amounted to $38.9 million in the second quarter of 2018 compared to $35.1 million recorded in the second quarter of 2017. Noninterest expenses for the six months ended June 30, 2018 amounted to $82.5 million compared to $67.2 million in 2017. The increase in noninterest expenses in 2018 related primarily to the Company’s acquisitions of Carolina Bank and Asheville Savings Bank.

Index

Also impacting expenses were other growth initiatives, including continued growth of our SBA consulting firm and SBA lending division, as well as the acquisition of an insurance agency during the third quarter of 2017.

Income Taxes

Our effective tax rate for the second quarter of 2018 was 22.1% compared to 33.2% in the second quarter of 2017. For the six months ended June 30, 2018 and 2017, our effective tax rate was 22.1% and 33.2%, respectively. The lower effective tax rate in 2018 was due to the Tax Cuts and Jobs Act, which was signed into law in December 2017 and reduced the federal tax rate from 35% to 21%.

Balance Sheet and Capital

Total assets at June 30, 2018 amounted to $5.7 billion, a 26.3% increase from a year earlier. Total loans at June 30, 2018 amounted to $4.1 billion, a 22.9% increase from a year earlier, and total deposits amounted to $4.6 billion at June 30, 2018, a 25.0% increase from a year earlier. The significant increases are largely due to the acquisition of Asheville Savings Bank on October 1, 2017.

We also experienced steady organic loan and deposit growth during the first six months of 2018. Organic loan growth for the six months ended June 30, 2018 amounted to $107 million, or 5.2% annualized, and organic deposit growth amounted to $146.7 million, or 6.7% annualized during that same period. This growth was a result of ongoing internal initiatives to enhance loan and deposit growth, including our recent expansion into higher growth markets.

We remain well-capitalized by all regulatory standards, with a Total Risk-Based Capital Ratio at June 30, 2018 of 13.17%, an increase from the 12.61% reported at June 30, 2017. Our tangible common equity to tangible assets ratio was 8.59% at June 30, 2018, an increase of 61 basis points from a year earlier.

Components of Earnings

Net interest income is the largest component of earnings, representing the difference between interest and fees generated from earning assets and the interest costs of deposits and other funds needed to support those assets. Net interest income for the three month period ended June 30, 2018 amounted to $51.2 million, an increase of $11.3 million, or 28.3%, from the $39.9 million recorded in the second quarter of 2017. Net interest income on a tax-equivalent basis for the three month period ended June 30, 2018 amounted to $51.6 million, an increase of $11.0 million, or 27.1%, from the $40.6 million recorded in the second quarter of 2017. We believe that analysis of net interest income on a tax-equivalent basis is useful and appropriate because it allows a comparison of net interest income amounts in different periods without taking into account the different mix of taxable versus non-taxable investments that may have existed during those periods.

	Three Months Ended June 30,	
($ in thousands)	2018	2017
Net interest income, as reported	$51,232	39,916
Tax-equivalent adjustment	367	693
Net interest income, tax-equivalent	$51,599	40,609

Net interest income for the six month period ended June 30, 2018 amounted to $101.7 million, an increase of $27.5 million, or 37.1%, from the $74.2 million recorded in the first half of 2017. Net interest income on a tax-equivalent basis for the six month period ended June 30, 2018 amounted to $102.5 million, an increase of $27.0 million, or 35.7%, from the $75.5 million recorded in the comparable period of 2017.

	Six Months Ended June 30,	
($ in thousands)	2018	2017
Net interest income, as reported	$101,739	74,212
Tax-equivalent adjustment	723	1,278
Net interest income, tax-equivalent	$102,462	75,490

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

Index

For the six months ended June 30, 2018, the higher net interest income compared to the same period of 2017 was due primarily to the growth in our loans and deposits, as reflected in the tables below.

The following table presents an analysis of net interest income.

	For the Three Months Ended June 30,					
	2018			2017		
($ in thousands)	Average Volume	Average Rate	Interest Earned or Paid	Average Volume	Average Rate	Interest Earned or Paid
Assets						
Loans (1)	$4,133,689	4.99%	$51,451	$3,327,391	4.78%	$39,656
Taxable securities	409,478	2.41%	2,465	292,333	2.35%	1,710
Non-taxable securities	50,531	2.92%	368	60,252	2.84%	427
Short-term investments, principally federal funds	449,206	2.19%	2,451	309,617	1.34%	1,034
Total interest-earning assets	5,042,904	4.51%	56,735	3,989,593	4.31%	42,827
Cash and due from banks	94,525			74,918		
Premises and equipment	114,200			97,353		
Other assets	419,991			286,541		
Total assets	$5,671,620			$4,448,405		
Liabilities						
Interest bearing checking	$877,270	0.10%	$212	$689,406	0.06%	$108
Money market deposits	1,033,676	0.27%	707	791,967	0.18%	359
Savings deposits	442,671	0.19%	213	411,048	0.21%	218
Time deposits >$100,000	629,319	1.18%	1,850	488,141	0.72%	874
Other time deposits	281,704	0.36%	251	255,682	0.27%	173
Total interest-bearing deposits	3,264,640	0.40%	3,233	2,636,244	0.26%	1,732
Borrowings	407,052	2.24%	2,270	307,964	1.54%	1,179
Total interest-bearing liabilities	3,671,692	0.60%	5,503	2,944,208	0.40%	2,911
Noninterest bearing checking	1,247,919			974,700		
Other liabilities	34,034			32,706		
Shareholders' equity	717,975			496,791		
Total liabilities and shareholders' equity	$5,671,620			$4,448,405		
Net yield on interest-earning assets and net interest income		4.07%	$51,232		4.01%	$39,916
Net yield on interest-earning assets and net interest income – tax-equivalent (2)		4.10%	$51,599		4.08%	$40,609
Interest rate spread		3.91%			3.91%	

Average prime rate	4.80%	4.04%

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

(2) Includes tax-equivalent adjustments of $367,000 and $693,000 in 2018 and 2017, respectively, to reflect the tax benefit that we receive related to tax-exempt securities and tax-exempt loans, which carry interest rates lower than similar taxable investments/loans due to their tax exempt status. This amount has been computed assuming a 23% tax rate for 2018 and 37% for 2017 and is reduced by the related nondeductible portion of interest expense.

Index

($ in thousands)	For the Six Months Ended June 30, 2018 Average Volume	Average Rate	Interest Earned or Paid	2017 Average Volume	Average Rate	Interest Earned or Paid
Assets						
Loans (1)	$4,116,592	4.98%	$101,621	$3,115,335	4.75%	$73,359
Taxable securities	410,032	2.48%	5,051	289,110	2.28%	3,265
Non-taxable securities	51,738	2.92%	748	56,835	3.09%	870
Short-term investments, principally federal funds	401,904	2.20%	4,376	272,779	1.33%	1,801
Total interest-earning assets	4,980,266	4.53%	111,796	3,734,059	4.28%	79,295
Cash and due from banks	93,855			71,107		
Premises and equipment	115,078			89,765		
Other assets	421,369			252,164		
Total assets	$5,610,568			$4,147,095		
Liabilities						
Interest bearing checking	$881,349	0.09%	$411	$671,039	0.06%	$215
Money market deposits	1,019,632	0.25%	1,282	760,345	0.18%	695
Savings deposits	445,728	0.19%	418	342,081	0.18%	297
Time deposits >$100,000	614,523	1.09%	3,325	462,460	0.69%	1,588
Other time deposits	282,191	0.34%	470	250,240	0.27%	339
Total interest-bearing deposits	3,243,423	0.37%	5,906	2,486,165	0.25%	3,134
Borrowings	407,105	2.06%	4,151	276,414	1.42%	1,949
Total interest-bearing liabilities	3,650,528	0.56%	10,057	2,762,579	0.37%	5,083
Noninterest bearing checking	1,214,759			895,696		
Other liabilities	35,588			32,405		
Shareholders' equity	709,693			456,415		
Total liabilities and shareholders' equity	$5,610,568			$4,147,095		
Net yield on interest-earning assets and net interest income		4.12%	$101,739		4.01%	$74,212
Net yield on interest-earning assets and net interest income – tax-equivalent (2)		4.15%	$102,462		4.08%	$75,490
Interest rate spread		3.97%			3.91%	
Average prime rate		4.66%			3.92%	

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

(2) Includes tax-equivalent adjustments of $723,000 and $1,278,000 in 2018 and 2017, respectively, to reflect the tax benefit that we receive related to tax-exempt securities and tax-exempt loans, which carry interest rates lower than similar taxable investments/loans due to their tax exempt status. This amount has been computed assuming a 23% tax rate for 2018 and 37% for 2017 and is reduced by the related nondeductible portion of interest expense.

The tables above reflect significant increases in our levels of loan and deposit balances. These increases were a result of organic growth, which was approximately 5%-8% over the periods reflected, and more significantly growth we assumed in our acquisitions. On March 3, 2017, we acquired Carolina Bank, which had $498 million in loans and $585 million in deposits, and on October 1, 2017 we acquired Asheville Savings Bank, which had $606 million in loans and $679 million in deposits.

Our net interest margin (tax-equivalent net interest income divided by average earning assets, referred to as "net yield on interest-earning assets" in the tables above) for the periods reflected above was fairly stable, ranging from 4.08%-4.15%. Both asset yields and liability costs have increased approximately 18-25 basis points in 2018 compared to the same periods of 2017 shown above due to increases in the interest rate environment. While loan yields have increased higher than deposit costs, which has benefitted our net interest margin, our interest rates on borrowings are highly correlated to short term interest rates set by the Federal Reserve and have increased more significantly.

Impacting our net interest margin for all periods reflected in the tables above are net accretion of purchase accounting premiums/discounts associated with acquired loans and deposits. For the three months ended June 30, 2018 and 2017, we recorded $2.4 million and $2.0 million, respectively, in net accretion of purchase accounting premiums/discounts that increased net interest income. For the six months ended June 30, 2018 and 2017, we recorded $4.5 million and $3.5 million, respectively. The increase in accretion in 2018 is due to the aforementioned acquisitions. Unaccreted loan discount has increased from $18.0 million at June 30, 2017 to $25.0 million at June 30, 2018 primarily as a result of the Asheville Savings Bank acquisition.

Index

The mix of our loan portfolio remained substantially the same at June 30, 2018 compared to December 31, 2017, with approximately 88% of our loans being real estate loans, 10% being commercial, financial, and agricultural loans, and the remaining 2% being consumer installment loans. The majority of our real estate loans are personal and commercial loans where real estate provides additional security for the loan.

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

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

We recorded a negative provision for loan losses (reduction of the allowance for loan losses) of $0.7 million in second quarter of 2018 compared to no provision for loan losses for the second quarter of 2017. For the six months ended June 30, 2018, we recorded total negative provision for loan losses of $4.4 million compared to a total provision for loan losses of $0.7 million in the same period of 2017. During the first half of 2018, we experienced net loan recoveries of $4.4 million compared to net loan charge-offs of $0.5 million in the first half of 2017.

Our provision for loan loss levels have been impacted by continued improvement in asset quality. Nonperforming assets amounted to $51.2 million at June 30, 2018, a decrease of 7.0% from the $55.0 million one year earlier. Our nonperforming assets to total assets ratio was 0.90% at June 30, 2018 compared to 1.21% at June 30, 2017. Annualized net charge-offs (recoveries) as a percentage of average loans for the six months ended June 30, 2018 was (0.21%), compared to 0.03% for the same period of 2017.

Total noninterest income was $16.1 million in the second quarter of 2018 compared to $11.9 million for the second quarter of 2017. For the six months ended June 30, 2018, noninterest income amounted to $32.1 million compared to $21.7 million for the same period of 2017.

As presented in the table below, core noninterest income for the second quarter of 2018 was $15.3 million, an increase of 31.6% from the $11.6 million reported for the second quarter of 2017. For the first six months of 2018, core noninterest income amounted to $31.5 million, a 47.2% increase from the $21.4 million recorded in the comparable period of 2017. As noted above, core noninterest income includes i) service charges on deposit accounts, ii) other service charges, commissions, and fees, iii) fees from presold mortgage loans, iv) commissions from sales of insurance and financial products, and v) SBA consulting fees, vi) SBA loan sale gains, and vii) bank-owned life insurance income.

The following table presents our core noninterest income for the three and six month periods ending June 30, 2018 and 2017, respectively.

$ in thousands	For the Three Months Ended June 30, 2018	For the Three Months Ended June 30, 2017	For the Six Months Ended June 30, 2018	For the Six Months Ended June 30, 2017
Service charges on deposit accounts	$3,122	2,966	6,385	5,580
Other service charges, commissions, and fees	4,913	3,554	9,510	6,727
Fees from presold mortgage loans	796	1,511	1,655	2,279
Commissions from sales of insurance and financial products	2,119	1,038	4,059	1,878
SBA consulting fees	1,126	1,050	2,267	2,310
SBA loan sale gains	2,598	927	6,400	1,549
Bank-owned life insurance income	628	580	1,251	1,088
Core noninterest income	$15,302	11,626	31,527	21,411

As shown in the table above, service charges on deposit accounts increased from $3.0 million in the second quarter of 2017 to $3.1 million in the second quarter of 2018. For the six months ended June 30, 2018, service charges on deposit accounts amounted to $6.4 million, which is a $0.8 million increase from the $5.6 million recorded in the comparable period of 2017. The increase in 2018 was primarily due to the aforementioned acquisitions.

Index

Other service charges, commissions, and fees increased in 2018 compared to 2017, primarily due to a combination of the aforementioned acquisitions and a result of higher debit card and credit card interchange fees. We earn a small fee each time a customer uses a debit card to make a purchase. Due to the growth in checking accounts and increased customer usage of debit cards, we have experienced increases in this line item. Interchange income from credit cards has also increased due to growth in the number and usage of credit cards, which we believe is a result of increased promotion of this product.

Fees from presold mortgages amounted to $0.8 million and $1.7 million for the three and six month periods ended June 30, 2018, respectively, compared to $1.5 million and $2.3 million for the three and six month periods ended June 30, 2017, respectively. The declines in 2018 are primarily due to our mortgage loan department originating a higher percentage of loans with construction components that are retained in our loan portfolio.

Commissions from sales of insurance and financial products amounted to $2.1 million in the second quarter of 2018, compared to $1.0 million in the second quarter of 2017. For the six months ended June 30, 2018 and 2017, the Company recorded $4.1 million and $1.9 million, respectively, in commissions from sales of insurance and financial products. The increase was primarily due to the acquisition of an insurance agency during the third quarter of 2017.

The largest increase in core noninterest income in 2018 was in our SBA loan sale gains, which resulted from an increase in sales volumes. During the first half of 2018, we sold $82.4 million of the guaranteed portions of newly originated SBA loans, which resulted in $6.4 million in gains on sales. In comparison, during the first half of 2017, we sold $20.6 million of the guaranteed portions, resulting in $1.5 million in gains on sales.

Bank-owned life insurance income was $1.3 million in the first six months of 2018 and $1.1 million in the first six months of 2017, which increased due to bank-owned life insurance policies assumed in the aforementioned acquisitions.

During the six months ended June 30, 2017, we recorded $0.2 million in losses from sales of securities. For the comparable period of 2018, we had no sales of securities.

Other gains and losses for the periods presented represent the net effects of miscellaneous gains and losses that are non-routine in nature. We recorded other gains of $0.9 million in the second quarter of 2018, which primarily related to a gain on a sale of a previously closed branch building. In the second quarter of 2017, we reported other gains of $0.5 million, which primarily related to the sale of a pool of default judgements to a third-party firm.

Noninterest expenses amounted to $38.9 million in the second quarter of 2018, a 10.8% increase over the $35.1 million recorded in the same period of 2017. Noninterest expenses for the six months ended June 30, 2018 amounted to $82.5 million compared to $67.2 million in 2017. The increase in noninterest expenses in 2018 related primarily to the acquisitions we completed in 2017.

Also impacting expenses were other growth initiatives, including continued growth of our SBA consulting firm and SBA lending division.

The acquisition activity was primarily responsible for the increase in salaries expense, which increased to $18.4 million in the second quarter of 2018 from the $16.3 million recorded in the second quarter of 2017. Salaries expense for the first half of 2018 amounted to $37.8 million compared to $30.2 million in 2017.

Employee benefits expense was also impacted by the acquisition activity and amounted to $4.1 million in the second quarter of 2018 compared to $4.0 million in the second quarter of 2017. For the first six months of 2018, employee benefits expense amounted to $8.7 million compared to $8.0 million in 2017. Also increasing expense in 2018 was our increased 401k match effective January 1, 2018, which increased from effectively a 100% match up to 4% of an employee's salary contribution to a 100% match up to 6% of an employee's salary contribution.

Occupancy and equipment expense increased in 2018 primarily due to the acquisitions discussed above. For the three months ended June 30, 2018, occupancy and equipment expense totaled $3.8 million compared to $3.7 million in the second quarter of 2017. For the six months ended June 30, 2018, occupancy and equipment expense totaled $7.8 million compared to $7.0 million in the first half of 2017.

Index

Merger and acquisition expenses amounted to $0.6 million and $3.4 million for the three and six months ended June 30, 2018, respectively, and include $0.6 million and $1.4 million of expense related to increases in an earn-out liability associated with a prior year acquisition, respectively. Merger and acquisition expenses amounted to $1.1 million and $3.5 million for the three and six months ended June 30, 2017, respectively.

Intangibles amortization expense increased from $1.0 million in the second quarter of 2017 to $1.7 million in the second quarter of 2018 and from $1.6 million in the first half of 2017 to $3.4 million in the first half of 2018,

primarily as a result of the amortization of intangible assets that we recorded in connection with our acquisitions.

Other operating expenses amounted to $10.2 million and $8.9 million for the second quarters of 2018 and 2017, respectively, and $21.3 million in the first half of 2018 compared to $16.9 million in the first half of 2017, with the increases primarily due to the acquisitions of Carolina Bank and Asheville Savings Bank. On March 16, 2018, we converted the data processing systems of Asheville Savings Bank to First Bank and consolidated three branches in Asheville, which was partially responsible for the decline in total noninterest expenses declining from $43.6 million in the first quarter of 2018 to $38.9 million in the second quarter of 2018.

For the second quarter of 2018, the provision for income taxes was $6.5 million, an effective tax rate of 22.1%, compared to $5.6 million for the same period of 2017, which is an effective tax rate of 33.2%. For the first six months of 2018, the provision for income taxes was $12.3 million, an effective tax rate of 22.1%, compared to $9.3 million for the same period of 2017, which was an effective tax rate of 33.2%. The lower effective tax rate in 2018 was due to the Tax Cuts and Jobs Act, which was signed into law in December 2017 and reduced the federal tax rate from 35% to 21%.

The consolidated statements of comprehensive income reflect other comprehensive loss of $1.5 million during the second quarter of 2018 compared to other comprehensive income of $1.3 million during the second quarter of 2017. During the six months ended June 30, 2018 and 2017, we recorded other comprehensive loss of $7.0 million and other comprehensive income of $2.2 million, respectively. The primary component of other comprehensive income for the periods presented was changes in unrealized holding gains (losses) of our available for sale securities. Our available for sale securities portfolio is predominantly comprised of fixed rate bonds that generally increase in value when market yields for fixed rate bonds decrease and decline in value when market yields for fixed rate bonds increase, which occurred in the first half of 2018 and was primarily responsible for the other comprehensive loss. Management has evaluated any unrealized losses on individual securities at each period end and determined that there is no other-than-temporary impairment.

Index

FINANCIAL CONDITION

Total assets at June 30, 2018 amounted to $5.7 billion, a 26.3% increase from a year earlier. Total loans at June 30, 2018 amounted to $4.1 billion, a 22.9% increase from a year earlier, and total deposits amounted to $4.6 billion, a 25.0% increase from a year earlier.

The following table presents information regarding the nature of changes in our levels of loans and deposits for the twelve months ended June 30, 2018 and for the first six months of 2018.

July 1, 2017 to June 30, 2018	Balance at beginning of period	Internal Growth, net	Growth from Acquisitions (1)	Balance at end of period	Total percentage growth	Internal percentage growth
Total loans	$3,375,976	167,234	606,180	4,149,390	22.9%	5.0%
Deposits – Noninterest bearing checking	990,004	128,454	133,756	1,252,214	26.5%	13.0%
Deposits – Interest bearing checking	728,973	13,488	173,205	915,666	25.6%	1.9%
Deposits – Money market	781,086	64,635	175,938	1,021,659	30.8%	8.3%
Deposits – Savings	411,814	(34,122)	62,783	440,475	7.0%	-8.3%
Deposits – Brokered	167,669	36,267	34,162	238,098	42.0%	21.6%
Deposits – Internet time	9,779	(2,780)	—	6,999	-28.4%	-28.4%
Deposits – Time>$100,000	304,716	61,622	35,771	402,109	32.0%	20.2%
Deposits – Time<$100,000	250,289	(37,410)	63,522	276,401	10.4%	-14.9%
Total deposits	$3,644,330	230,154	679,137	4,553,621	25.0%	6.3%
January 1, 2018 to June 30, 2018						
Total loans	$4,042,369	107,021	—	4,149,390	2.6%	2.6%
Deposits – Noninterest bearing checking	1,196,161	56,053	—	1,252,214	4.7%	4.7%
Deposits – Interest bearing checking	884,254	31,412	—	915,666	3.6%	3.6%
Deposits – Money market	982,822	38,837	—	1,021,659	4.0%	4.0%
Deposits – Savings	454,860	(14,385)	—	440,475	-3.2%	-3.2%
Deposits – Brokered	239,659	(1,561)	—	238,098	-0.7%	-0.7%
Deposits – Internet time	7,995	(996)	—	6,999	-12.5%	-12.5%
Deposits – Time>$100,000	347,862	54,247	—	402,109	15.6%	15.6%
Deposits – Time<$100,000	293,342	(16,941)	—	276,401	-5.8%	-5.8%
Total deposits	$4,406,955	146,666	—	4,553,621	3.3%	3.3%

(1) Includes the acquisition of Asheville Savings Bank on October 1, 2017, which had $606.2 million in loans and $679.1 million in deposits.

As derived from the table above, for the twelve months preceding June 30, 2018, our total loans increased $773.4 million, or 22.9%. The loan growth from acquisitions is due to our acquisition of Asheville Savings Bank, which had $606 million on the date of acquisition. Asheville Savings Bank operated through 13 branches in the Asheville region of North Carolina. Internal loan growth was $167.2 million, or 5.0%, for the twelve months ended June 30, 2018 and was $107.0 million, or 2.6%, for the first six months of 2018 (5.2% annualized). Internal loan growth has been driven by our continued expansion into high-growth markets. We expect continued growth in our loan portfolio throughout the remainder of 2018.

The mix of our loan portfolio remains substantially the same at June 30, 2018 compared to December 31, 2017. The majority of our real estate loans are personal and commercial loans where real estate provides additional security for the loan. Note 8 to the consolidated financial statements presents additional detailed information regarding our mix of loans.

We have also experienced growth in our deposit balances. Total deposits increased by $909 million for the twelve months ended June 30, 2018, an increase of 25.0%. Of that increase, $679 million was assumed in the Asheville Savings Bank acquisition. Internal growth for that same period amounted to $230 million, or 6.3%. For the six months ended June 30, 2018, deposit growth amounted to $147 million, or 3.3% (6.6% annualized). We have experienced higher growth in our transaction accounts (checking, money market, and savings) compared to time deposits, which we believe is due customers favoring transaction accounts due to their higher liquidity and the fact that transaction accounts have not been paying materially lower interest rates compared to time deposits. However, we have recently seen some of our customers with larger balances transfer funds from their money market accounts to the time deposit > $100,000 category to attain higher interest rates.

Index

Impacting the deposit growth discussed above was the receipt of a $41 million money market deposit in the first quarter of 2018 that is expected to be transferred outside the Company in the third quarter of 2018.

Our overall liquidity increased slightly since June 30, 2017. Our liquid assets (cash and securities) as a percentage of our total deposits and borrowings increased from 18.8% at June 30, 2017 to 20.2% at June 30, 2018. Brokered deposits and borrowings as a percent of overall funding remained substantially unchanged among the periods presented.

Nonperforming Assets

Nonperforming assets include nonaccrual loans, troubled debt restructurings, loans past due 90 or more days and still accruing interest, and foreclosed real estate. Nonperforming assets are summarized as follows:

ASSET QUALITY DATA *($ in thousands)*	As of/for the quarter ended June 30, 2018	As of/for the quarter ended December 31, 2017	As of/for the quarter ended June 30, 2017
Nonperforming assets			
Nonaccrual loans	$25,494	20,968	22,795
Restructured loans – accruing	17,386	19,834	21,019
Accruing loans >90 days past due	—	—	—
Total nonperforming loans	42,880	40,802	43,814
Foreclosed real estate	8,296	12,571	11,196
Total nonperforming assets	$51,176	53,373	55,010
Purchased credit impaired loans not included above (1)	$20,832	23,165	16,846
Asset Quality Ratios – All Assets			
Net charge-offs to average loans – annualized	(0.07%)	0.13%	(0.06%)
Nonperforming loans to total loans	1.03%	1.01%	1.30%
Nonperforming assets to total assets	0.90%	0.96%	1.21%
Allowance for loan losses to total loans	0.56%	0.58%	0.71%
Allowance for loan losses + unaccreted discount to total loans	1.16%	1.24%	1.24%
Allowance for loan losses to nonperforming loans	54.33%	57.10%	54.83%

(1)

In the March 3, 2017 acquisition of Carolina Bank and the October 1, 2017 acquisition of Asheville Savings Bank, we acquired $19.3 million and $9.9 million, respectively, in PCI loans in accordance with ASC 310-30 accounting guidance. These loans are excluded from the nonperforming loan amounts, including $0.5 million, $0.6 million, and $0.4 million in PCI loans at June 30, 2018, December 31, 2017, and June 30, 2017, respectively, that were contractually past due 90 days or more.

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

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

As noted in the table above, at June 30, 2018, total nonaccrual loans amounted to $25.5 million, compared to $21.0 million at December 31, 2017 and $22.8 million at June 30, 2017. Nonaccrual loans have generally declined in recent years as our local economies have improved, and we continue to focus on resolving our problem assets. In the second quarter of 2018, we classified two loan relationships comprising three loans totaling approximately $3 million to nonaccrual status. We believe the loans are well-secured and will result in minimal losses.

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

($ in thousands)	At June 30, 2018	At December 31, 2017	At June 30, 2017
Commercial, financial, and agricultural	$3,407	1,001	1,027
Real estate – construction, land development, and other land loans	1,374	1,822	1,007
Real estate – mortgage – residential (1-4 family) first mortgages	11,513	12,201	15,262
Real estate – mortgage – home equity loans/lines of credit	1,765	2,524	1,942
Real estate – mortgage – commercial and other	7,292	3,345	3,451
Installment loans to individuals	143	75	106
Total nonaccrual loans	$25,494	20,968	22,795

"Restructured loans – accruing", or troubled debt restructurings ("TDRs"), are accruing loans for which we have granted concessions to the borrower as a result of the borrower's financial difficulties. At June 30, 2018, total accruing TDRs amounted to $17.4 million, compared to $19.8 million at December 31, 2017 and $21.0 million at June 30, 2017.

Index

Foreclosed real estate includes primarily foreclosed properties. Total foreclosed real estate amounted to $8.3 million at June 30, 2018, $12.6 million at December 31, 2017, and $11.2 million at June 30, 2017. Our foreclosed property balances have generally been decreasing as a result of sales activity during the periods and the improvement in our overall asset quality. In the fourth quarter of 2017, we acquired Asheville Savings Bank and assumed approximately $3 million of foreclosed real estate in this transaction.

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

($ in thousands)	At June 30, 2018	At December 31, 2017	At June 30, 2017
Vacant land	$2,521	6,032	4,132
1-4 family residential properties	3,973	4,229	4,648
Commercial real estate	1,802	2,310	2,416
Total foreclosed real estate	$8,296	12,571	11,196

The following table presents geographical information regarding our nonperforming assets at June 30, 2018.

	As of June 30, 2018			
($ in thousands)	Total Nonperforming Loans	Total Loans	Nonperforming Loans to Total Loans	Total Foreclosed Real Estate
Region (1)				
Eastern Region (NC)	$13,314	868,000	1.5%	304
Triangle Region (NC)	11,510	856,000	1.3%	1,486
Triad Region (NC)	7,819	914,000	0.9%	1,227
Charlotte Region (NC)	1,024	278,000	0.4%	264
Southern Piedmont Region (NC)	6,430	267,000	2.4%	1,228
Western Region (NC)	598	689,000	0.1%	1,958
South Carolina Region	1,785	144,000	1.2%	669
Former Virginia Region	355	2,000	17.8%	1,160
Other	45	131,000	0.0%	—
Total	$42,880	4,149,000	1.0%	8,296

(1) The counties comprising each region are as follows:
Eastern North Carolina Region - New Hanover, Brunswick, Duplin, Dare, Beaufort, Pitt, Onslow, Carteret

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

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

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

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

Western North Carolina Region – Buncombe, Henderson, McDowell, Madison, Transylvania

South Carolina Region - Chesterfield, Dillon, Florence

Former Virginia Region - Wythe, Washington, Montgomery, Roanoke

Other includes loans originated on a national basis through the Company’s SBA Lending Division

Index

Summary of Loan Loss Experience

The allowance for loan losses is created by direct charges to operations (known as a "provision for loan losses" for the period in which the charge is taken). Losses on loans are charged against the allowance in the period in which such loans, in management's opinion, become uncollectible. The recoveries realized during the period are credited to this allowance.

We have no foreign loans, few agricultural loans and do not engage in significant lease financing or highly leveraged transactions. Commercial loans are diversified among a variety of industries. The majority of our real estate loans are primarily personal and commercial loans where real estate provides additional security for the loan. Collateral for virtually all of these loans is located within our principal market area.

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

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

($ in thousands)	Six Months Ended June 30, 2018	Twelve Months Ended December 31, 2017	Six Months Ended June 30, 2017
Loans outstanding at end of period	$4,149,390	4,042,369	3,375,976
Average amount of loans outstanding	$4,116,592	3,420,939	3,115,335
Allowance for loan losses, at beginning of year	$23,298	23,781	23,781
Provision (reversal) for loan losses	(4,369)	723	723
	18,929	24,504	24,504
Loans charged off:			
Commercial, financial, and agricultural	(609)	(1,622)	(1,204)
Real estate – construction, land development & other land loans	(32)	(589)	(269)
Real estate – mortgage – residential (1-4 family) first mortgages	(415)	(2,641)	(1,247)
Real estate – mortgage – home equity loans / lines of credit	(186)	(978)	(578)
Real estate – mortgage – commercial and other	(312)	(1,182)	(414)
Installment loans to individuals	(262)	(799)	(359)

Total charge-offs	(1,816)	(7,811)	(4,071)
Recoveries of loans previously charged-off:			
Commercial, financial, and agricultural	812	1,311	518
Real estate – construction, land development & other land loans	3,387	2,579	1,471
Real estate – mortgage – residential (1-4 family) first mortgages	516	1,076	636
Real estate – mortgage – home equity loans / lines of credit	243	333	130
Real estate – mortgage – commercial and other	1,124	1,027	698
Installment loans to individuals	103	279	139
Total recoveries	6,185	6,605	3,592
Net recoveries (charge-offs)	4,369	(1,206)	(479)
Allowance for loan losses, at end of period	$23,298	23,298	24,025
Ratios:			
Net charge-offs (recoveries) as a percent of average loans (annualized)	(0.21%)	0.04%	0.03%
Allowance for loan losses as a percent of loans at end of period	0.56%	0.58%	0.71%
Allowance for loan losses + unaccreted discount as a percent of loans	1.16%	1.24%	1.24%

We recorded a negative provision for loan losses (reduction of the allowance for loan losses) of $4.4 million in the first six months of 2018, compared to a provision for loan losses of $0.7 million in the first six months of 2017.

Index

The provision for loan losses that we record is driven by an allowance for loan loss mathematical model, with the primary factors impacting this model being loan growth, asset quality trends, and net charge-off history. The net charge-off history component incorporates our net charge-offs experienced in the most recent years. Thus, older periods systematically age out and are excluded from the analysis as time goes on. In most recent quarters, the new periods have had significantly lower net charge-offs (and net recoveries in some periods) than the older periods rolling out of the model. This has resulted in a lower required amount of allowance for loan losses in our modeling. The low level of net-charge offs (or net recoveries) experienced over the past two years has been the primary reason for the low (or negative) provisions for loan losses recorded.

The allowance for loan losses amounted to $23.3 million at June 30, 2018, compared to $23.3 million at December 31, 2017 and $24.0 million at June 30, 2017. The ratio of our allowance to total loans has declined from 0.71% at June 30, 2017 to 0.56% at June 30, 2018 as a result of the factors discussed above that impacted our provision for loan losses, as well as applicable accounting guidance that does not allow us to record an allowance for loan losses upon the acquisition of loans. Instead acquired loans are recorded at their discounted fair value, which includes the consideration of any expected losses. No allowance for loan losses is recorded for the acquired loans until the expected credit losses exceed the remaining unamortized discounts – based on an individual basis for purchased credit impaired loans and on a pooled basis for performing acquired loans. See Critical Accounting Policies above for further discussion. Unaccreted discount, which is available to absorb loan losses, amounted to $25.0 million, $26.9 million, and $18.0 million at June 30, 2018, December 31, 2017, and June 30, 2017, respectively. The ratio of allowance for loan losses plus unaccreted discount was 1.16%, 1.24%, and 1.24% at June 30, 2018, December 31, 2017, and June 30, 2017, respectively.

We believe our reserve levels are adequate to cover probable loan losses on the loans outstanding as of each reporting date. It must be emphasized, however, that the determination of the reserve using our procedures and methods rests upon various judgments and assumptions about economic conditions and other factors affecting loans. No assurance can be given that we will not in any particular period sustain loan losses that are sizable in relation to the amounts reserved or that subsequent evaluations of the loan portfolio, in light of conditions and factors then prevailing, will not require significant changes in the allowance for loan losses or future charges to earnings. See "Critical Accounting Policies – Allowance for Loan Losses" above.

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

Based on the results of our loan analysis and grading program and our evaluation of the allowance for loan losses at June 30, 2018, there have been no material changes to the allocation of the allowance for loan losses among the various categories of loans since December 31, 2017.

Liquidity, Commitments, and Contingencies

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

In addition to internally generated liquidity sources, we have the ability to obtain borrowings from the following three sources - 1) an approximately $910 million line of credit with the Federal Home Loan Bank (of which $353 million was outstanding at June 30, 2018 and $354 million was outstanding at December 31, 2017), 2) a $35 million federal funds line with a correspondent bank (of which none was outstanding at June 30, 2018 or December 31, 2017), and 3) an approximately $129 million line of credit through the Federal Reserve Bank of Richmond’s discount window (of which none was outstanding at June 30, 2018 or December 31, 2017). In addition to the outstanding borrowings from the FHLB that reduce the available borrowing capacity of that line of credit, our borrowing capacity was reduced by $190 million at June 30, 2018 and $198 million at December 31, 2017, as a result of our pledging letters of credit for public deposits at each of those dates. Unused and available lines of credit amounted to $531 million at June 30, 2018 compared to $528 million at December 31, 2017.

Our overall liquidity increased since June 30, 2017. Our liquid assets (cash and securities) as a percentage of our total deposits and borrowings increased from 18.8% at June 30, 2017 to 20.2% at June 30, 2018.

Index

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

The amount and timing of our contractual obligations and commercial commitments has not changed materially since December 31, 2017, detail of which is presented in Table 18 on page 82 of our 2017 Annual Report on Form 10-K.

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

Off-Balance Sheet Arrangements and Derivative Financial Instruments

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

Derivative financial instruments include futures, forwards, interest rate swaps, options contracts, and other financial instruments with similar characteristics. We have not engaged in significant derivative activities through June 30, 2018, and have no current plans to do so.

Capital Resources

The Company is regulated by the Board of Governors of the Federal Reserve Board (“Federal Reserve”) and is subject to the securities registration and public reporting regulations of the Securities and Exchange Commission. Our banking subsidiary, First Bank, is also regulated by the North Carolina Office of the Commissioner of Banks. We are not aware of any recommendations of regulatory authorities or otherwise which, if they were to be implemented, would have a material effect on our liquidity, capital resources, or operations.

We must comply with regulatory capital requirements established by the Federal Reserve. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. Our capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The capital standards require us to maintain minimum ratios of “Common Equity Tier 1” capital to total risk-weighted assets, “Tier 1” capital to total risk-weighted assets, and total capital to risk-weighted assets of 4.50%, 6.00% and 8.00%, respectively. Common Equity Tier 1 capital is comprised of common stock and related surplus, plus retained earnings, and is reduced by goodwill and other intangible assets, net of associated deferred tax liabilities. Tier 1 capital is comprised of Common Equity Tier 1 capital plus Additional Tier 1 Capital, which for the Company includes trust preferred securities. Total capital is comprised of Tier 1 capital plus certain adjustments, the largest of which is our allowance for loan losses. Risk-weighted assets refer to our on- and off-balance sheet exposures, adjusted for their related risk levels using formulas set forth in Federal Reserve regulations.

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

In addition to the risk-based capital requirements described above, we are subject to a leverage capital requirement, which calls for a minimum ratio of Tier 1 capital (as defined above) to quarterly average total assets of 3.00% to 5.00%, depending upon the institution’s composite ratings as determined by its regulators. The Federal Reserve has not advised us of any requirement specifically applicable to us.

Index

At June 30, 2018, our capital ratios exceeded the regulatory minimum ratios discussed above. The following table presents our capital ratios and the regulatory minimums discussed above for the periods indicated.

	June 30, 2018	December 31, 2017	June 30, 2017
Risk-based capital ratios:			
Common equity Tier 1 to Tier 1 risk weighted assets	11.41%	10.72%	10.44%
Minimum required Common equity Tier 1 capital	6.375%	5.75%	5.75%
Tier I capital to Tier 1 risk weighted assets	12.61%	11.94%	11.91%
Minimum required Tier 1 capital	7.875%	7.25%	7.25%
Total risk-based capital to Tier II risk weighted assets	13.17%	12.50%	12.61%
Minimum required total risk-based capital	9.875%	9.25%	9.25%
Leverage capital ratios:			
Tier 1 capital to quarterly average total assets	10.05%	9.58%	9.77%
Minimum required Tier 1 leverage capital	4.00%	4.00%	4.00%

First Bank is also subject to capital requirements that do not vary materially from the Company's capital ratios presented above. At June 30, 2018, First Bank significantly exceeded the minimum ratios established by the regulatory authorities.

In addition to regulatory capital ratios, we also closely monitor our ratio of tangible common equity to tangible assets ("TCE Ratio"). Our TCE ratio was 8.59% at June 30, 2018 compared to 8.23% at December 31, 2017 and 7.98% at June 30, 2017.

BUSINESS DEVELOPMENT MATTERS

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

- On June 15, 2018, the Company announced a quarterly cash dividend of $0.10 cents per share payable on July 25, 2018 to shareholders of record on June 30, 2018. The dividend rate represents a 25% increase over the previous dividend rate of $0.08 the Company declared in the second quarter of 2017.

SHARE REPURCHASES

We did not repurchase any shares of our common stock during the first six months of 2018. At June 30, 2018, we had approximately 214,000 shares available for repurchase under existing authority from our board of directors. We may repurchase these shares in open market and privately negotiated transactions, as market conditions and our liquidity warrants, subject to compliance with applicable regulations. See also Part II, Item 2 “Unregistered Sales of Equity Securities and Use of Proceeds.”

Item 3 – Quantitative and Qualitative Disclosures About Market Risk

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

Net interest income is our most significant component of earnings. Notwithstanding changes in volumes of loans and deposits, our level of net interest income is continually at risk due to the effect that changes in general market interest rate trends have on interest yields earned and paid with respect to our various categories of earning assets and interest-bearing liabilities. It is our policy to maintain portfolios of earning assets and interest-bearing liabilities with maturities and repricing opportunities that will afford protection, to the extent practical, against wide interest rate fluctuations. Our exposure to interest rate risk is analyzed on a regular basis by management using standard GAP reports, maturity reports, and an asset/liability software model that simulates future levels of interest income and expense based on current interest rates, expected future interest rates, and various intervals of “shock” interest rates. Over the years, we have been able to maintain a fairly consistent yield on average earning assets (net interest margin). Over the past five calendar years, our net interest margin has ranged from a low of 4.03% (realized in 2016) to a high of 4.92% (realized in 2013). Up until the end of 2015, the prime rate of interest had remained at 3.25% since 2008. In response to Federal Reserve actions, the prime rate increased to 3.50% on December 31, 2015 and to 3.75% on December 15, 2016. In 2017 and 2018, Federal Reserve actions steadily increased the prime rate five additional times, up to 5.00%, which was the rate at June 30, 2018. The consistency of the net interest margin is aided by the relatively low level of long-term interest rate exposure that we maintain. At June 30, 2018, approximately 77% of our interest-earning assets were subject to repricing within five years (because they are either adjustable rate assets or they are fixed rate assets that mature) and substantially all of our interest-bearing liabilities reprice within five years.

Index

Using stated maturities for all fixed rate instruments except mortgage-backed securities (which are allocated in the periods of their expected payback) and securities and borrowings with call features that are expected to be called (which are shown in the period of their expected call). At June 30, 2018, we had $1.3 billion more in interest-bearing liabilities that are subject to interest rate changes within one year than earning assets. This generally would indicate that net interest income would experience downward pressure in a rising interest rate environment and would benefit from a declining interest rate environment. However, this method of analyzing interest sensitivity only measures the magnitude of the timing differences and does not address earnings, market value, or management actions. Also, interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. In addition to the effects of "when" various rate-sensitive products reprice, market rate changes may not result in uniform changes in rates among all products. For example, included in interest-bearing liabilities subject to interest rate changes within one year at June 30, 2018 are deposits totaling $2.4 billion comprised of checking, savings, and certain types of money market deposits with interest rates set by management. These types of deposits historically have not repriced with, or in the same proportion, as general market indicators.

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

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

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

As it relates to deposits, the Federal Reserve made no changes to the short term interest rates it sets directly from 2008 until mid-December 2015, and since that time we have been able to reprice many of our maturing time deposits at lower interest rates. We were also able to generally decrease the rates we paid on other categories of deposits as a result of declining short-term interest rates in the marketplace and an increase in liquidity that lessened our need to offer premium interest rates. However, as our average funding rate approached zero several years ago, meaningful further declines were not possible. Thus far, the seven interest rate increases initiated by the Federal Reserve over the past few years have not resulted in significant competitive pressure to increase deposit rates, although we are choosing to pay higher rates to price-sensitive customers in certain situations.

Index

As previously discussed in the section “Net Interest Income,” our net interest income has been impacted by certain purchase accounting adjustments related to acquired banks. The purchase accounting adjustments related to the premium amortization on loans, deposits and borrowings are based on amortization schedules and are thus systematic and predictable. The accretion of the loan discount on acquired loans, which amounted to $4.4 million and $3.3 million for the six months ended June 30, 2018 and 2017, respectively, is less predictable and could be materially different among periods. This is because of the magnitude of the discounts that were initially recorded and the fact that the accretion being recorded is dependent on both the credit quality of the acquired loans and the impact of any accelerated loan repayments, including payoffs. If the credit quality of the loans declines, some, or all, of the remaining discount will cease to be accreted into income. If the underlying loans experience accelerated paydowns or improved performance expectations, the remaining discount will be accreted into income on an accelerated basis. In the event of total payoff, the remaining discount will be entirely accreted into income in the period of the payoff. Each of these factors is difficult to predict and susceptible to volatility. The remaining loan discount on acquired accruing loans amounted to $25.0 million at June 30, 2018.

Based on our most recent interest rate modeling, which assumes one or two additional interest rate increases for the remainder of 2018 (federal funds rate = 2.25%-2.50%, prime = 5.25%-5.50%), we project that our net interest margin will likely remain fairly stable for the remainder of the year. We expect asset yields to increase, and we also expect that we will experience pressure to increase our deposit rates.

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

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

Item 4 – Controls and Procedures

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, which are our controls and other procedures that are designed to ensure that information required to be disclosed in our periodic reports with the Securities and Exchange Commission (“SEC”) is recorded, processed, summarized and reported within the required time periods. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed is communicated to our management to allow timely decisions regarding required disclosure. Based on the evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective in allowing timely decisions regarding disclosure to be made about material information required to be included in our periodic reports with the SEC. In addition, no change in our internal control over financial reporting has occurred during, or subsequent to, the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Part II. Other Information

Item 1 – Legal Proceedings

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

Item 1A – Risk Factors

Investing in shares of our common stock involves certain risks, including those identified and described in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, as well as cautionary statements contained in this Form 10-Q, including those under the caption “Forward-Looking Statements” set forth in the forepart of this Form 10-Q, risks and matters described elsewhere in this Form 10-Q and in our other filings with the SEC.

Index

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

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased (2)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1)
April 1, 2018 to April 30, 2018	—	—	—	214,241
May 1, 2018 to May 31, 2018	—	—	—	214,241
June 1, 2018 to June 30, 2018	—	—	—	214,241
Total	—	—	—	214,241

Footnotes to the Above Table

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

(2) The table above does not include shares that were used by option holders to satisfy the exercise price of the call options issued by the Company to its employees and directors pursuant to the Company's stock option plans. In the second quarter of 2018, 2,964 shares of our common stock, with a weighted average market price of $39.91 per share, were used to satisfy an exercise of options.

During the three months ended June 30, 2018, there were no unregistered sales of the Company's securities.

Item 6 - Exhibits

The following exhibits are filed with this report or, as noted, are incorporated by reference. Except as noted below the exhibits identified have Securities and Exchange Commission File No. 000-15572. Management contracts, compensatory plans and arrangements are marked with an asterisk (*).

2.a	Purchase and Assumption Agreement dated as of March 3, 2016 between First Bank (as Seller) and First Community Bank (as Purchaser) was filed as Exhibit 99.2 to the Company's Current Report on Form 8-K filed on March 7, 2016, and is incorporated herein by reference.
2.b	Purchase and Assumption Agreement dated as of March 3, 2016 between First Community Bank (as Seller) and First Bank (as Purchaser) was filed as Exhibit 99.3 to the Company's Current Report on Form 8-K filed on March 7, 2016, and is incorporated herein by reference.
2.c	Merger Agreement between First Bancorp and Carolina Bank Holdings, Inc. dated June 21, 2016 was filed as Exhibit 2.1 to the Company's Current Report on Form 8-K filed on June 22, 2016, and is incorporated herein by reference.
2.d	Merger Agreement between First Bancorp and ASB Bancorp, Inc. dated May 1, 2017 was filed as Exhibit 2.1 to the Company's Current Report on Form 8-K filed on May 1, 2017, and is incorporated herein by reference
3.a	Articles of Incorporation of the Company and amendments thereto were filed as Exhibits 3.a.i through 3.a.v to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2002, and are incorporated herein by reference. Articles of Amendment to the Articles of Incorporation were filed as Exhibits 3.1 and 3.2 to the Company's Current Report on Form 8-K filed on January 13, 2009, and are incorporated herein by reference. Articles of Amendment to the Articles of Incorporation were filed as Exhibit 3.1.b to the Company's Registration Statement on Form S-3D filed on June 29, 2010 (Commission File No. 333-167856), and are incorporated herein by reference. Articles of Amendment to the Articles of Incorporation were filed as Exhibit 3.1 to the Company's Current Report on Form 8-K filed on September 6, 2011, and are incorporated herein by reference. Articles of Amendment to the Articles of Incorporation were filed as Exhibit 3.1 to the Company's Current Report on Form 8-K filed on December 26, 2012, and are incorporated herein by reference

Index

3.b	Amended and Restated Bylaws of the Company were filed as Exhibit 3.1 to the Company's Current Report on Form 8-K filed on February 9, 2018, and are incorporated herein by reference.
4.a	Form of Common Stock Certificate was filed as Exhibit 4 to the Company’s Quarterly Report on Form 10-Q for the quarter ended June 30, 1999, and is incorporated herein by reference.
31.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
31.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
32.1	Chief Executive Officer Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Chief Financial Officer Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following financial information from the Company’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2018, formatted in eXtensible Business Reporting Language (XBRL): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Shareholders’ Equity, (v) the Consolidated Statements of Cash Flows, and (vi) the Notes to Consolidated Financial Statements.

Copies of exhibits are available upon written request to: First Bancorp, Elizabeth B. Bostian, Secretary, 300 SW Broad Street, Southern Pines, North Carolina, 28387

Index

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FIRST BANCORP

August 9, 2018 BY:/s/ Richard H. Moore
Richard H. Moore
Chief Executive Officer
(Principal Executive Officer),
and Director

August 9, 2018 BY:/s/ Eric P. Credle
Eric P. Credle
Executive Vice President
and Chief Financial Officer