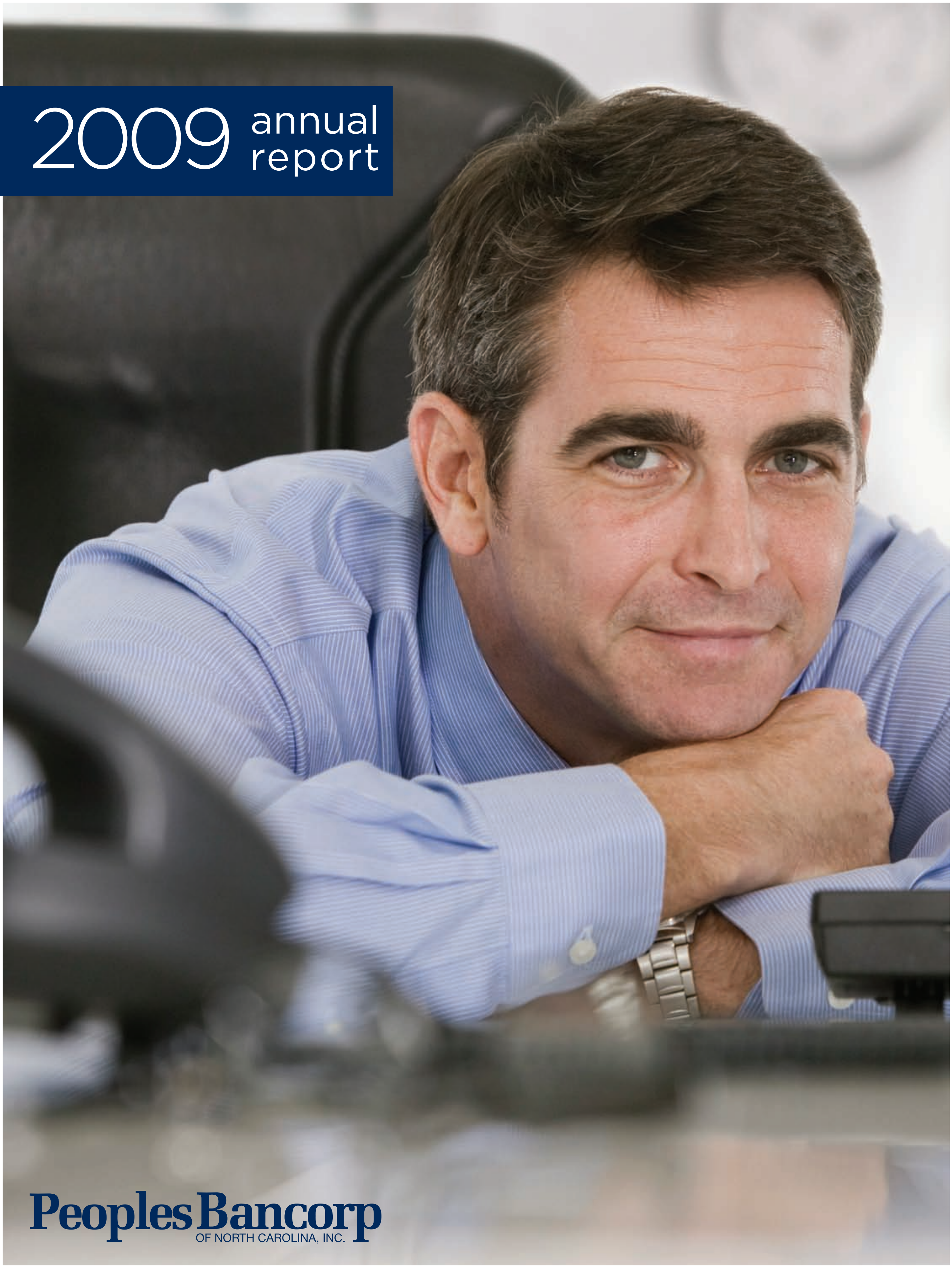
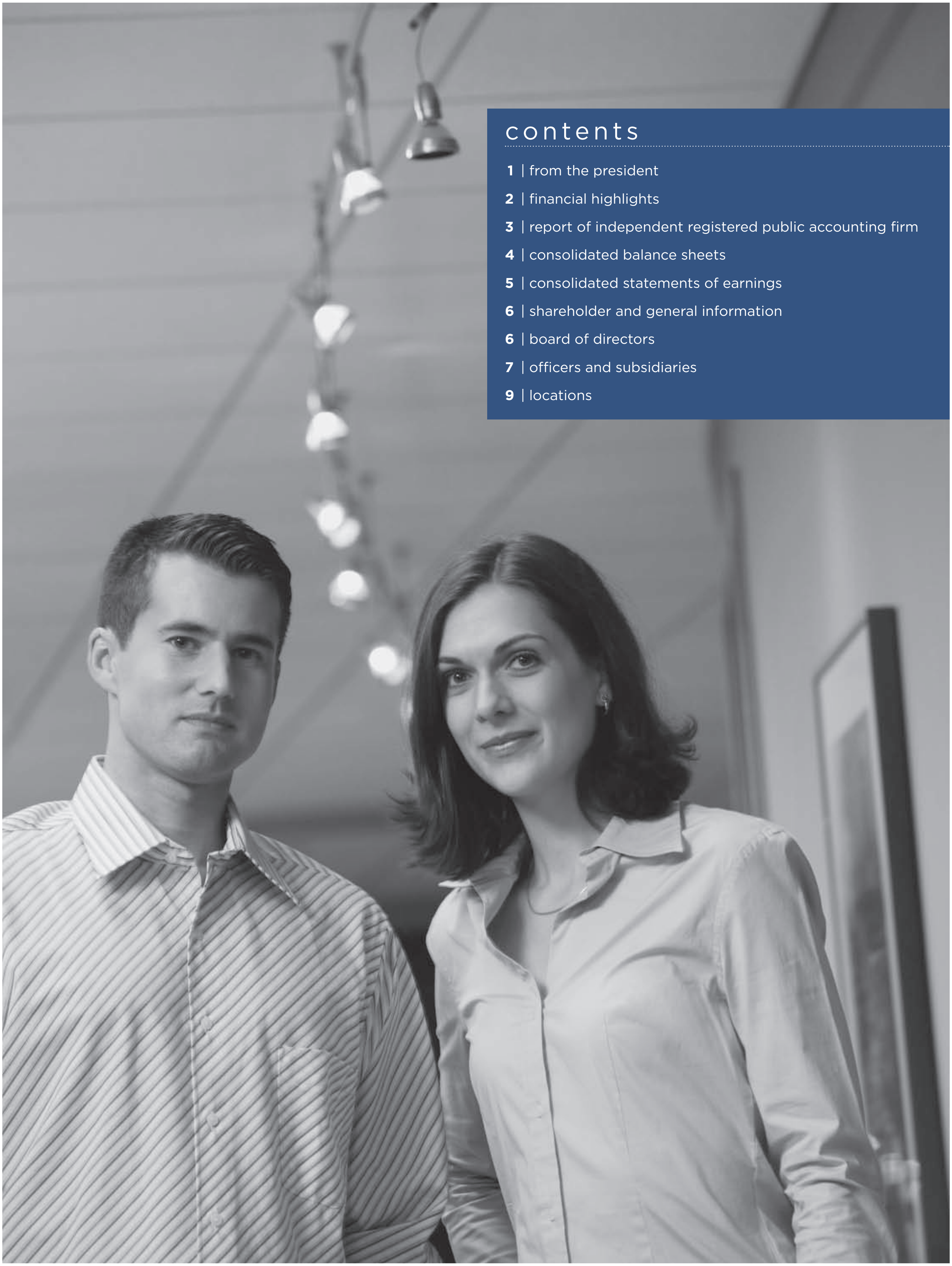
2009 annual report



Peoples Bancorp
OF NORTH CAROLINA, INC.



contents

from the president

I am pleased to report to you that Peoples Bancorp of North Carolina was profitable for fiscal year ended December 31, 2009. As you are aware, economic conditions throughout the region and nation resulted in significant uncertainty for the financial industry throughout 2009. Even though the recession appeared to end in the summer of last year, it is anticipated that the economic recovery will remain gradual throughout 2010 and will not fully recover for some time. Although maintaining profitability during 2009, financial performance at Peoples Bancorp of North Carolina, Inc. was adversely impacted due to the effects of local unemployment, reduced real estate values, and sharply deteriorating economic conditions in general. Consolidated net earnings amounted to $2.9 million, or $0.53 basic and diluted net earnings per share before adjustment for preferred stock dividends and accretion for the fiscal year ended December 31, 2009. In comparison, consolidated net earnings totaled $6.4 million, or $1.14 basic net earnings per share and $1.13 diluted net earnings per share for the 2008 fiscal year. After adjusting for $1.2 million in dividends and accretion on preferred stock, net earnings available to common shareholders for the year ended December 31, 2009 were $1.7 million, or $0.30 basic and diluted net earnings per share.

Despite the challenges brought about by the economic recession, Peoples Bancorp continued to earn recognition among peer companies as one of North Carolina's safest and best performing financial institutions. Cited by two prominent ratings services, BauerFinancial announced their rating of "Excellent" using December 31, 2009 financials, while BankRate.com disclosed their rating of "Performing" based on September 30, 2009 financials.

Peoples Bancorp was approved for participation in the U.S. Treasury Department's Capital Purchase Program ("CPP") under the Troubled Asset Relief Program (TARP). Our Company issued $24.4 million in Series A preferred stock and a warrant for shares of common stock with a value of $704,000 on December 23, 2008. While it is our desire to repay this loan as quickly as feasible, we maintain that the decision to accept the funds was in the best interest of capital preservation given the continued deteriorating economic conditions that we have experienced.

Shareholders' equity totaled $99.2 million, or 9.46% of total assets, at December 31, 2009. For the prior fiscal year, shareholders' equity amounted to $101.1 million, or 10.44% of total assets. During 2009 your Board of Directors adjusted the payment of cash dividends to common shareholders to assist in the protection of the Company's capital base. Total cash dividends distributed to shareholders were $0.26 per common share for the 2009 fiscal year. I am pleased to report that Peoples Bancorp remains classified as a well-capitalized financial institution according to the regulatory definition.

Asset growth was 8% during 2009 and crossed the billion dollar threshold for the first time. Total assets amounted to $1.0 billion at December 31, 2009 as compared to $968.8 million one year ago. The Company's loan portfolio totaled $778.1 million at December 31, 2009 while investment securities available for sale grew 56% to $195.1 million resulting from partial deployment of TARP funding. Non-performing assets totaled $28.8 million, or 2.74% of total assets at year-end 2009 and were a direct reflection of current economic challenges as noted above. The allowance for loan losses at December 31, 2009 amounted to $15.4 million, or 1.98% of total loans, compared to $11.0 million, or 1.41% of total loans at December 31, 2008.

Total deposits amounted to $809.3 million and represented an increase of 12% over 2008. The Company maintained its focus on the attraction of core deposits as a fundamental goal for the year just ended. I am extremely pleased with the results of our efforts as core deposits, which comprise our least expensive funding source, increased $71.8 million, or 14%, to $569.0 million during 2009. We will continue these efforts into the new year as these deposits play a vital role in today's low interest rate environment.

Peoples Bank opened its second office in the Mooresville market during 2009 in the Trade Court Shoppes at Mooresville Gateway. This office represents a natural extension of our existing footprint in an area that has been identified as desirable for future growth. The new office is located at the intersection of Williamson Road (U.S. Highway 21) and Interstate 77 at Exit 33. We have been pleased with the level of reception we have received in this new neighborhood.

In May, 2009 we formed an additional subsidiary, Community Bank Real Estate Solutions, Inc. (CBRES), to address changes in the mortgage industry associated with the "Home Valuation Code of Conduct." The formation of this new company has enabled the generation of additional fee income from this sector of our business. CBRES serves Peoples Bank as well as other community banks with appraisal management services. Real Estate Advisory Services, Inc. (REAS) continues to provide real estate appraisals (both residential and commercial) to the Bank's market area.

Peoples Investment Services, Inc. represents another wholly-owned subsidiary of Peoples Bank and complements the Bank's traditional array of financial products. Through an exclusive relationship with Raymond James Financial Services, Inc., our customers receive access to stocks, bonds, mutual funds, annuities, or other suitable monetary investments.

Although operating in an economic environment that was less than desirable in 2009, we accomplished many of our goals that were initially adopted. We realize that the current situation is only temporary and feel that we are appropriately positioned to capitalize upon market opportunities when conditions improve. Our community bankers remain positive and engaged. They maintain a passion to discover opportunities to exceed customers' expectations while adding value to the financial relationship. I wish to express my personal appreciation to each of them for their professionalism and dedication as we move forward.

I also would like to recognize members of Peoples Bancorp Board of Directors who have provided guidance during this period of economic turmoil. Their insight and commitment to appropriate corporate governance are invaluable, and I thank them on behalf of our shareholders for the service they have provided throughout the year. Shareholders are cordially invited to attend the 2010 Annual Meeting of Shareholders scheduled for Thursday, May 6, beginning at 11:00 A.M. The meeting will once again be held at Catawba Country Club in Newton.

Thank you for your continued interest and support on behalf of Peoples Bancorp as we enter our 98th year of service. We look forward to working with you as we enter the new decade.

Sincerely,

Tony W. Wolfe
President and Chief Executive Officer

financial highlights

December 31, 2009 and 2008
(dollars in thousands, except per share amounts)

		2009	2008	Change
Interest income	$	50,037	56,322	-11%
Interest expense		17,187	23,526	-27%
Net interest earnings after provision for loan losses		22,315	28,002	-20%
Non-interest income		11,823	10,495	13%
Non-interest expense		29,883	28,893	3%
Income taxes		1,339	3,213	-58%
Net earnings		2,916	6,391	-54%
Dividends and accretion of preferred stock		1,246	-	-
Net earnings available to common shareholders	$	1,670	6,391	-74%
Per Share of Common Stock				
Basic net earnings	$	0.30	1.14	-74%
Diluted net earnings		0.30	1.13	-73%
Cash dividends		0.26	0.48	-46%
Market price at December 31		4.95	9.18	-46%
Book value at December 31		13.37	13.73	-3%
At Year-end				
Loans, net	$	762,643	770,163	-1%
Available for sale securities		195,115	124,916	56%
Assets		1,048,494	968,762	8%
Deposits		809,343	721,062	12%
Shareholders' equity		99,223	101,128	-2%
Key Performance Ratios				
Return on average assets		0.29%	0.69%	
Return on average shareholders' equity		2.88%	8.38%	
Dividend payout ratio*		86.22%	41.93%	
Average shareholders' equity to total average assets		9.95%	8.20%	

*As a percentage of net earnings available to common shareholders.

Porter Keadle Moore, LLP

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders
Peoples Bancorp of North Carolina, Inc.
Newton, North Carolina

We have audited the consolidated balance sheets of Peoples Bancorp of North Carolina, Inc. as of December 31, 2009 and 2008, and the related consolidated statements of earnings, changes in shareholders' equity, comprehensive income and cash flows for each of the three years in the period ended December 31, 2009. Such consolidated financial statements and our report thereon dated February 25, 2010, expressing an unqualified opinion (which are not included herein), are included in the proxy statement for the 2010 annual meeting of shareholders. The accompanying condensed consolidated balance sheets and consolidated statements of earnings are the responsibility of the Company's management. Our responsibility is to express an opinion on such consolidated balance sheets and consolidated statements of earnings in relation to the complete consolidated financial statements.

In our opinion, the information set forth in the accompanying condensed consolidated balance sheets as of December 31, 2009 and 2008 and the related consolidated statements of earnings for each of the three years in the period ended December 31, 2009, is fairly stated in all material respects in relation to the basic consolidated financial statements from which it has been derived.

Porter Keadle Moore, LLP

Atlanta, Georgia
February 25, 2010

Certified Public Accountants
Suite 1800 • 235 Peachtree Street NE • Atlanta, Georgia 30303 • Phone 404-588-4200 • Fax 404-588-4222 • www.pkm.com

consolidated balance sheets

December 31, 2009 and 2008
(dollars in thousands)

Assets		2009	2008
Cash and due from banks, including reserve requirements of $5,017,000 and $7,257,000	$	29,633	19,743
Interest bearing deposits		1,707	1,453
Federal funds sold		-	6,733
Cash and cash equivalents		31,340	27,929
Certificates of deposit		3,345	-
Investment securities available for sale		195,115	124,916
Other investments		6,346	6,303
Total securities		201,461	131,219
Mortgage loans held for sale		2,840	-
Loans		778,056	781,188
Less allowance for loan losses		(15,413)	(11,025)
Net loans		762,643	770,163
Premises and equipment, net		17,947	18,297
Cash surrender value of life insurance		7,282	7,019
Accrued interest receivable and other assets		21,636	14,135
Total assets	$	1,048,494	968,762
Liabilities and Shareholders' Equity			
Deposits:			
Non-interest bearing demand	$	117,636	104,448
NOW, MMDA & savings		290,273	210,058
Time, $100,000 or more		233,142	220,374
Other time		168,292	186,182
Total deposits		809,343	721,062
Demand notes payable to U.S. Treasury		636	1,600
Securities sold under agreement to repurchase		36,876	37,501
Short-term Federal Reserve Bank borrowings		-	5,000
FHLB borrowings		77,000	77,000
Junior subordinated debentures		20,619	20,619
Accrued interest payable and other liabilities		4,797	4,852
Total liabilities		949,271	867,634
Shareholders' equity:			
Series A preferred stock, $1,000 stated value; authorized 5,000,000 shares; issued and outstanding 25,054 shares in 2009 and 2008		24,476	24,350
Common stock, no par value; authorized 20,000,000 shares; issued and outstanding 5,539,056 shares in 2009 and 2008		48,269	48,269
Retained earnings		23,573	22,985
Accumulated other comprehensive income		2,905	5,524
Total shareholders' equity		99,223	101,128
Total liabilities and shareholders' equity	$	1,048,494	968,762

Refer to Appendix A of Peoples Bancorp of North Carolina, Inc. Proxy Statement, dated March 29, 2010, for a complete set of Consolidated Financial Statements.

consolidated statements of earnings

For the Years Ended December 31, 2009, 2008 and 2007
(dollars in thousands)

		2009	2008	2007
Interest income:				
Interest and fees on loans	$	43,211	50,604	55,401
Interest on federal funds sold		1	55	383
Interest on investment securities:				
U.S. Government sponsored enterprises		5,461	4,392	4,572
States and political subdivisions		1,242	904	888
Other		122	367	488
Total interest income		50,037	56,322	61,732
Interest expense:				
NOW, MMDA & savings deposits		2,965	3,249	4,099
Time deposits		9,687	15,008	17,430
FHLB borrowings		3,577	3,616	3,759
Junior subordinated debentures		546	1,016	1,476
Other		412	637	821
Total interest expense		17,187	23,526	27,585
Net interest income		32,850	32,796	34,147
Provision for loan losses		10,535	4,794	2,038
Net interest income after provision for loan losses		22,315	28,002	32,109
Other income:				
Service charges		5,573	5,203	4,278
Other service charges and fees		2,058	2,399	1,938
Gain (loss) on sale and write-down of securities		1,072	(167)	(562)
Mortgage banking income		827	660	561
Insurance and brokerage commissions		414	426	521
Loss on sale and write-down of other real estate and repossessed assets		(501)	(287)	(118)
Miscellaneous		2,380	2,261	2,198
Total other income		11,823	10,495	8,816
Other expense:				
Salaries and employee benefits		14,758	15,194	13,888
Occupancy		5,409	5,029	4,751
Other		9,716	8,670	7,354
Total other expenses		29,883	28,893	25,993
Earnings before income taxes		4,255	9,604	14,932
Income taxes		1,339	3,213	5,340
Net earnings		2,916	6,391	9,592
Dividends and accretion of preferred stock		1,246	-	-
Net earnings available to common shareholders	$	1,670	6,391	9,592
Basic earnings per common share	$	0.30	1.14	1.68
Diluted earnings per common share	$	0.30	1.13	1.65
Cash dividends declared per common share	$	0.26	0.48	0.41

Refer to Appendix A of Peoples Bancorp of North Carolina, Inc. Proxy Statement, dated March 29, 2010, for a complete set of Consolidated Financial Statements.

shareholder and general information

Annual Meeting

The Annual Meeting of Shareholders of Peoples Bancorp will be held at 11:00 A.M. on Thursday, May 6, 2010, at the Catawba Country Club located at 1154 Country Club Road, Newton, North Carolina.

Shareholders' Luncheon

Shareholders in attendance at the Annual Meeting are cordially invited to remain for a luncheon to be served immediately upon adjournment.

Common Stock

Peoples Bancorp common stock is traded on the over-the-counter (OTC) market and quoted in the NASDAQ (National Association of Securities Dealers Automated Quotations) Global Market, where our symbol is PEBK.

Price and volume information is contained in most major daily newspapers in the Over the Counter Markets section under the National Market System listing. Peoples Bancorp stock is marketed by Scott & Stringfellow, Inc. and Sterne Agee & Leach, Inc.

Dividend Reinvestment & Stock Purchase

Peoples Bancorp offers a Dividend Reinvestment and Stock Purchase Plan for the benefit of the Corporation's shareholders. The Plan provides for the full or partial reinvestment of cash dividends, optional cash purchases of the Corporation's stock, safekeeping of the share certificates, liquidation of shares, and gifting of shares and enrollment of the designated recipients.

Registrar and Transfer Company, Cranford, New Jersey, is the Plan Administrator. For more information, one may call the Investor Relations Department at Peoples Bancorp at 828-464-5620 or 800-948-7195 or contact the Plan Administrator at 800-368-5948.

Shareholders of Peoples Bancorp are entitled to receive dividends when and as declared by the Board of Directors out of funds legally available therefore.

Such dividend payments are declared based upon the guidelines of North Carolina and federal banking law.

As of March 17, 2010, the Company had 712 shareholders of record, not including the number of persons or entities whose stock is held in nominee or street name through various brokerage firms or banks.

Corporate Office

Peoples Bancorp of North Carolina, Inc.
518 West C Street
PO Box 467
Newton, NC 28658
828-464-5620

Stock Transfer Agent & Registrar

Registrar and Transfer Company
10 Commerce Drive
Cranford, NJ 07016-3572
www.rtco.com

Independent Auditors

Porter Keadle Moore, LLP
235 Peachtree Street, NE
Suite 1800
Atlanta, GA 30303

board of directors

Peoples Bank and Peoples Bancorp Board of Directors

Robert C. Abernethy
Chairman of the Board
Peoples Bancorp of North Carolina, Inc. and Peoples Bank
President, Secretary and Treasurer
Carolina Glove Company, Inc.

James S. Abernethy
President and Assistant Secretary
Midstate Contractors, Inc.

Douglas S. Howard
Vice President
Howard Ventures, Inc.
Secretary and Treasurer
Denver Equipment of Charlotte, Inc.

John W. Lineberger, Jr.
President
Lincoln Bonded Warehouse Company

Gary E. Matthews
President and Director
Matthews Construction Company, Inc.

Dr. Billy L. Price, Jr., M.D.
Managing Partner and Practitioner of Internal Medicine
Catawba Valley Internal Medicine, PA

Larry E. Robinson
President and Chief Executive Officer
The Blue Ridge Distributing Company, Inc.

W. Gregory Terry
Executive Vice President
Drum and Willis-Reynolds Funeral Homes and Crematory

Dan Ray Timmerman, Sr.
President and Chief Executive Officer
Timmerman Manufacturing, Inc.

Benjamin I. Zachary
President, Treasurer, General Manager and Director
Alexander Railroad Company

Peoples Bancorp Officers

Tony W. Wolfe
President and Chief Executive Officer

Joseph F. Beaman, Jr.
Executive Vice President and Corporate Secretary

A. Joseph Lampron
Executive Vice President, Chief Financial Officer and Corporate Treasurer

Lance A. Sellers
Executive Vice President and Assistant Corporate Secretary

William D. Cable, Sr.
Executive Vice President and Assistant Corporate Treasurer

Peoples Bank Officers

Tony W. Wolfe – President and Chief Executive Officer

Joseph F. Beaman, Jr. – Executive Vice President, Chief Administrative Officer and Corporate Secretary

A. Joseph Lampron – Executive Vice President, Chief Financial Officer

Lance A. Sellers – Executive Vice President, Chief Credit Officer

William D. Cable, Sr. – Executive Vice President, Chief Operating Officer

J. Manuel Rey – President, Banco de la Gente

Kimberly L. Boyd – Senior Vice President, Banking Support

James O. Perry – Senior Vice President, Retail Banking Manager

David E. Reitzel – Senior Vice President, Real Estate Administration

Daniel F. Richard – Senior Vice President, Senior Lender

Mark W. Sigmon – Senior Vice President, Area Executive

Clifton A. Wike – Senior Vice President, Senior Lender

Kimberly D. Bazzle – First Vice President, Marketing

David C. Brown – First Vice President, Certified Financial Planner

Steven F. Cloninger – First Vice President, Credit Administration

George S. Earp – First Vice President, Finance

Jeffrey P. Gniadek – First Vice President, Area Executive

Kyle E. Sigmon – First Vice President, Consumer Credit

Tammy H. Stephens – First Vice President, Director of Information Technology

Brenda L. Terrell – First Vice President, Operations Manager

John M. Woods – First Vice President, Area Executive

Angela J. Abernethy – Vice President, Business Services Sales Manager

J. LaShae Bock – Vice President, Human Resources Director

Velvet L. Bowman – Vice President, Service Center Manager

Christopher L. Brookshire – Vice President, RAA/GAA

Helga Y. Callaway - Vice President, Business Center Manager, Catawba Valley Blvd

Peggy W. Carpenter – Vice President, Business Center Manager, North Newton

Wendy E. Cordero – Vice President, Banco de la Gente Operations Manager

Deborah W. Craig - Vice President, Director of Learning and Development

Kay F. Deal – Vice President, Business Center Manager, Conover

John R. Duncan – Vice President, Problem Asset Manager

Barbara K. Farnsworth – Vice President, Business Center Manager, Lincolnton

Mark W. Gustafson – Vice President, Investment Account Executive

Tommie A. Hall – Vice President, Loan Documentation

Leslie D. Hambrick – Vice President, Internal Auditor

Diane L. Klein – Vice President, Business Center Manager, Viewmont

M. Beth LaBarbera – Vice President, Business Center Manager, Springs Road

E. Dean Lawing – Vice President, Mortgage Lending Manager

David S. Lewis, Jr. – Vice President, Business Development Officer

Julian F. Miguel – Vice President, Banco de la Gente Mortgage Manager

Wendy H. Moran – Vice President, Business Center Manager, Triangle

Connie P. Ollis – Vice President, Compliance Officer

Paula M. Parker – Vice President, Business Center Manager, Claremont

Hight D. Reid – Vice President, Business Center Manager, West Lincoln

Jeanette R. Ringley – Vice President, Business Center Manager, Newton

Lucretia K. Rogers – Vice President, Business Center Manager, Cornelius

Joe S. Tripp – Vice President, Business Development Officer

Denise C. Williams – Vice President, Business Center Manager, Mooresville/Gateway

Peoples Bancorp Subsidiary Board of Directors and Officers

Community Bank Real Estate Solutions, LLC

Board of Directors	Officers
Robert C. Abernethy	Tony W. Wolfe – President
David E. Reitzel	David E. Reitzel – Vice President
Dan Ray Timmerman, Sr.	Joseph F. Beaman, Jr. – Secretary
Tony W. Wolfe	A. Joseph Lampron – Treasurer

Peoples Bank Subsidiaries' Board of Directors and Officers

Peoples Investment Services, Inc.

Board of Directors	Officers
Robert C. Abernethy	Tony W. Wolfe – President
Dr. Billy L. Price, Jr.	David C. Brown – Vice President and Assistant Secretary
David C. Brown	Joseph F. Beaman, Jr. – Secretary
Larry E. Robinson	A. Joseph Lampron – Treasurer
Douglas S. Howard	
Tony W. Wolfe	

Real Estate Advisory Services, Inc.

Board of Directors	Officers
Robert C. Abernethy	Tony W. Wolfe – President
Dan Ray Timmerman, Sr.	David E. Reitzel – Vice President
David E. Reitzel	Joseph F. Beaman, Jr. – Secretary
Tony W. Wolfe	A. Joseph Lampron – Treasurer

Working hard to be a bank for real people.

Real people are people like us. People who live and work in the same community. People we see at school, at church and at the grocery store. People who are our friends, our family and our customers. Day in, day out, we focus on what's important: being a real Peoples Bank.

locations

www.peoplesbanknc.com

Peoples Bancorp Center
518 West C Street
PO Box 467
Newton, NC 28658
(828) 464-5620
Toll-free (800) 948-7195

Customer Service Center
(828) 466-1765
Toll-free (877) 802-1212

Catawba
106 North Main Street
Catawba, NC 28609
(828) 241-3123

Catawba Valley Boulevard
2050 Catawba Valley Blvd. SE
Hickory, NC 28602
(828) 322-6372

Claremont
3261 East Main Street
Claremont, NC 28610
(828) 459-7152

Conover
213 First Street West
Conover, NC 28613
(828) 464-8456

Cornelius
9624-I Bailey Road
Cornelius, NC 28031
(704) 237-9270

Denver
6125 Highway 16 South
Denver, NC 28037
(704) 483-3050

Hiddenite
5153 NC Highway 90 East
Hiddenite, NC 28636
(828) 632-0118
(704) 585-6631

Lincolnton
1910 East Main Street
Lincolnton, NC 28092
(704) 732-0097

Maiden
200 Island Ford Road
Maiden, NC 28650
(828) 428-9874

Mooresville
1074 River Highway
Mooresville, NC 28117
(704) 658-3600

Mooresville Gateway
125-E Trade Court
Mooresville, NC 28117
(704) 663-0384

Newton
420 West A Street
Newton, NC 28658
(828) 464-5663

North Newton
2619 North Main Avenue
Newton, NC 28658
(828) 464-8664

Springs Road
3310 Springs Road NE
Hickory, NC 28601
(828) 256-9229

Triangle
142 Highway 16 South
Denver, NC 28037
(704) 483-7727
(704) 827-2370

Viewmont
1333 2nd Street NE
Hickory, NC 28601
(828) 345-6262

West Lincoln
760 Highway 27 West
Lincolnton, NC 28092
(704) 736-1447

Satellite Location
Abernethy Laurels
102 Leonard Avenue
Newton, NC 28658
(828) 464-3077

Banco de la Gente
6300 South Boulevard
Charlotte, NC 28217
(704) 554-7494

Banco de la Gente
4451-A Central Avenue
Charlotte, NC 28205
(704) 531-4571

Banco de la Gente
501 West Roosevelt Boulevard
Monroe, NC 28110
(704) 261-2020

Banco de la Gente
4011 Capital Boulevard
Suite 121
Raleigh, NC 27604
(919) 747-8000

Peoples Bancorp
OF NORTH CAROLINA, INC.

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