PeoplesBancorp

2016 Annual Report

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2016 Annual Report

From the President

It is a great privilege to present the 2016 Annual Report of business activity on behalf of Peoples Bancorp of North Carolina, Inc. In its 104th consecutive year of being presented, this report is a reflection of our enduring success, due largely to the unwavering commitment of our shareholders and to our employees, who continually provide outstanding service to the Company. Year-to-date highlights are as follows:

- Net earnings were $9.2 million or $1.68 basic net earnings per share and $1.65 diluted net earnings per share for the year ended December 31, 2016, as compared to $9.6 million or $1.73 basic net earnings per share and $1.72 diluted net earnings per share for the same period one year ago.
- Non-performing assets declined to $4.1 million or 0.4% of total assets at December 31, 2016, compared to $9.2 million or 0.9% of total assets at December 31, 2015.
- Total loans increased $34.7 million to $723.8 million at December 31, 2016, compared to $689.1 million at December 31, 2015.
- Core deposits were $865.4 million or 96.9% of total deposits at December 31, 2016, compared to $805.0 million or 96.7% of total deposits at December 31, 2015.
- 2016 non-interest expense reflects the following non-recurring expenses totaling $2.8 million:
    - $1.5 million consulting fees associated with the FDIC Consent Order issued in August 2015.
    - $1.3 million penalties on FHLB borrowing prepayments.

The preservation of our capital base continues to be a priority for us, as is our designation as a "well-capitalized" financial institution. Consequently, we are pleased to report, as of December 31, 2016 shareholders' equity was $107.4 million, or 9.9% of total assets, compared to $104.9 million, or 10.1% of total assets, as of December 31, 2015. This increase is primarily due to an increase in retained earnings due to net income, which was partially offset by a decrease in accumulated other comprehensive income resulting from a decrease in the unrealized gain on investment securities and a $2.0 million decrease in common stock due to 92,738 shares of common stock being repurchased under the Company's stock repurchase program implemented during the second quarter of 2016.

The allowance for loan losses at December 31, 2016 was $7.6 million or 1.0% of total loans, compared to $9.6 million or 1.4% of total loans at December 31, 2015. Management believes the current level of the allowance for loan losses is adequate; however, there is no assurance that additional adjustments to the allowance will not be required because of changes in economic conditions, regulatory requirements or other factors.

Our Bank's vision is to be the bank that is exceptional at serving our communities, including employees, customers and shareholders. First with our employees, we want our Bank to be a place where they feel valued and can grow, and are comfortable sharing new and different ideas to help us improve. In addition, we want to attract new employees who are passionate about people and understand the value of a career here.

With our customers, we want them to choose to bank with us, because we are reliable, trustworthy, progressive and supportive. A warm smile and a helpful voice in person or over the phone go a long way. Our goal is for our customers to have a banking experience so positive, so helpful that they recommend us to family, friends, and businesses.

Our final community is our shareholders. We want our shareholders to invest and support the bank because we do things the right way. We're a well-capitalized financial institution with strong earnings, and that's important. But our true value lies in our integrity, our passion for people and this community, and a desire to sell to our customers' needs.

Based on our past performance, we are greatly encouraged that our community trusts us with their banking needs and values our products and services. Our longstanding track record of success may be attributed to the fact that we're constantly evolving to meet the changing needs and demands of our communities, while staying true to the hometown values upon which this community bank was formed in 1912.

As we continue to progress, and as part of our pursuit to be the banking provider of choice for our families and businesses, we are introducing a different look for the Bank and a new promise to offer a higher level of service. Our complete brand story, which captures the essence of who we are and what our bank represents, is featured on the following page.

Our employees always go the extra mile for our customers and consistently demonstrate the core values of our Bank. I commend each of them for their hard work, dedication and loyalty, which make our Company a success.

The Directors of Peoples Bancorp play a direct and critical role in the success of our Company. They consistently endeavor to enhance shareholder value through their diligence, hard work and acumen.

Please join me in thanking them for their commitment. In addition to the Bank, which operates as a wholly owned subsidiary of the Company, we would like to remind you of our three subsidiary companies:

Peoples Investment Services, Inc., licensed financial advisors who provide access to investment products, which include stocks, bonds, mutual funds, annuities, and other suitable monetary investments through our affiliation with Raymond James Financial Services, Inc.

Real Estate Advisory Services, Inc., which provides real estate appraisals (both residential and commercial) to Peoples Bancorp's market area, thereby becoming a valued partner with respect to mortgage-related transactions.

Community Bank Real Estate Solutions, LLC, assists community banks across the country with appraisal management services.

The Annual Shareholders Meeting is scheduled for May 4, 2017 at Catawba Country Club beginning at 11 a.m. I hope each and every shareholder will attend the Annual Meeting. I want to express my appreciation for the loyalty and support of each of our shareholders, whom we hope will recommend our Bank and subsidiary companies to members of their communities.

Sincerely,

Lance A. Sellers
President and Chief Executive Officer

Our New Brand Is Exceptional

Our Bank has introduced a new brand that reflects our renewed promise to serve customers, employees and shareholders exceptionally well, and to inspire you to be your best self too. We're excited about it and hope you are as well.

As you know, the people of this community have always been at the very center of what we do and our new brand tells that story. We're passionate about reaching out, helping out, serving customers, doing the right thing and making each other and this community more extraordinary than ever.

Our tagline is "be exceptional." What this means is to be your best self, pursue your dreams, do what makes you happy, and achieve your greatest potential, and we'll do our part by being exceptional at serving you.

We believe there is something exceptional about everyone, and we're here to be your trusted, reliable, supportive partner along the way. We want to encourage and inspire you, and us, and this entire community to be outstanding in the way we care for each other.

So let's welcome our new brand, which captures the essence of our Bank and the people who serve it.

Our Promise

We strive to be exceptional and inspire others to be exceptional too.

Our Vision

To be the bank that's exceptional at serving our communities, including employees, customers and shareholders.

Our Mission

To provide exceptional customer service while selling to customer needs.

Our Core Values:

Employees
We are informed, encouraged,and committed.

Integrity
We are fair and truthful.

Exceptional Customer Service
We surpass our customers' expectations.

Accountability
We are accountable for our own actions and bank goals.

Progressive and Positive
We see change as an opportunity.

Be
Passionate
Energetic
Optimistic
Progressive
Loyal
Exceptional

We
believe there is power in possibility.
see the extraordinary in people.
celebrate the uniqueness in everyone.
deliver exceptional customer service.
do the right thing.
support our communities.
inspire others.
strive to be exceptional.
are **Peoples**Bank.

elliott davis decosimo

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Peoples Bancorp of North Carolina, Inc. and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of earnings, comprehensive income, changes in shareholders' equity and cash flows for the years then ended; and in our report, dated March 16, 2017, we expressed an unqualified opinion on those consolidated financial statements.

In our opinion, the information set forth in the accompanying condensed consolidated financial statements is fairly stated, in all material respects, in relation to the consolidated financial statements from which it has been derived.

Elliott Davis Decosimo, PLLC

Charlotte, North Carolina
March 16, 2017

Porter Keadle Moore
CPAs | Advisors | www.pkm.com

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, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of earnings, comprehensive income (loss), changes in shareholders' equity and cash flows for the year ended December 31, 2014 (not presented herein); and in our report dated March 25, 2015, we expressed an unqualified opinion on those consolidated financial statements.

In our opinion, the information set forth in the accompanying 2014 condensed consolidated financial statements is fairly stated, in all material respects, in relation to the basic 2014 consolidated financial statements from which it has been derived.

Porter Keadle Moore, LLC

Atlanta, Georgia
March 25, 2015

Consolidated Balance Sheets

For the Years Ended December 31, 2016 and 2015

(Dollars in thousands)

Assets		December 31, 2016	December 31, 2015
Cash and due from banks, including reserve requirements	$	53,613	29,194
of $16,576 at 12/31/16 and $14,587 at 12/31/15			
Interest-bearing deposits		16,481	10,569
Cash and cash equivalents		70,094	39,763
Investment securities available for sale		249,946	268,530
Other investments		2,635	3,636
Total securities		252,581	272,166
Mortgage loans held for sale		5,709	4,149
Loans		723,811	689,091
Less allowance for loan losses		(7,550)	(9,589)
Net loans		716,261	679,502
Premises and equipment, net		16,452	16,976
Cash surrender value of life insurance		14,952	14,546
Other real estate		283	739
Accrued interest receivable and other assets		11,659	10,640
Total assets	$	1,087,991	1,038,481
Liabilities and Shareholders' Equity			
Deposits:			
Noninterest-bearing demand	$	271,851	244,231
NOW, MMDA & savings		477,054	431,052
Time, $250,000 or more		26,771	26,891
Other time		117,242	130,001
Total deposits		892,918	832,175
Securities sold under agreements to repurchase		36,434	27,874
FHLB borrowings		20,000	43,500
Junior subordinated debentures		20,619	20,619
Accrued interest payable and other liabilities		10,592	9,449
Total liabilities		980,563	933,617
Commitments (Note 10)			
Shareholders' equity:			
Series A preferred stock, $1,000 stated value; authorized			
5,000,000 shares; no shares issued and outstanding		-	-
Common stock, no par value; authorized			
20,000,000 shares; issued and outstanding 5,417,800 shares			
at December 31, 2016 and 5,510,538 shares at December 31, 2015		44,187	46,171
Retained earnings		60,254	53,183
Accumulated other comprehensive income		2,987	5,510
Total shareholders' equity		107,428	104,864
Total liabilities and shareholders' equity	$	1,087,991	1,038,481

See Appendix A to the Peoples Bancorp of North Carolina, Inc. Proxy Statement, dated March 24, 2017, for a complete set of Consolidated Financial Statements.

Consolidated Statements of Earnings

For the Years Ended December 31, 2016, 2015 and 2014

(Dollars in thousands, except per share amounts)

		2016	2015	2014
Interest income:				
Interest and fees on loans	$	32,452	31,098	30,305
Interest on due from banks		123	26	65
Interest on investment securities:				
U.S. Government sponsored enterprises		2,531	2,616	2,995
States and political subdivisions		4,454	4,600	4,677
Other		249	326	378
Total interest income		39,809	38,666	38,420
Interest expense:				
NOW, MMDA & savings deposits		495	432	499
Time deposits		586	870	1,188
FHLB borrowings		1,661	1,735	2,166
Junior subordinated debentures		485	402	389
Other		44	45	45
Total interest expense		3,271	3,484	4,287
Net interest income		36,538	35,182	34,133
(Reduction of) provision for loan losses		(1,206)	(17)	(699)
Net interest income after provision for loan losses		37,744	35,199	34,832
Non-interest income:				
Service charges		4,497	4,647	4,961
Other service charges and fees		890	931	1,080
Gain on sale of securities		729	-	266
Mortgage banking income		1,428	1,130	804
Insurance and brokerage commissions		632	714	701
Gain (loss) on sales and write-downs of other real estate		64	245	(622)
Miscellaneous		5,736	5,645	4,974
Total non-interest income		13,976	13,312	12,164
Non-interest expense:				
Salaries and employee benefits		19,264	18,285	17,530
Occupancy		6,765	6,288	6,251
Professional fees		2,439	1,468	1,401
Advertising		1,136	784	804
Debit card expense		1,141	988	905
FDIC insurance		494	681	739
Other		8,743	7,284	8,041
Total non-interest expense		39,982	35,778	35,671
Earnings before income taxes		11,738	12,733	11,325
Income tax expense		2,561	3,100	1,937
Net earnings	$	9,177	9,633	9,388
Basic net earnings per common share	$	1.68	1.73	1.67
Diluted net earnings per common share	$	1.65	1.72	1.66
Cash dividends declared per common share	$	0.38	0.28	0.18

See Appendix A to the Peoples Bancorp of North Carolina, Inc. Proxy Statement, dated March 24, 2017, for a complete set of Consolidated Financial Statements.

Peoples Bank and Peoples Bancorp Board of Directors

Robert C. Abernethy
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President and Assistant Secretary
Midstate Contractors, Inc.

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Vice President, Secretary and Treasurer
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President
Lincoln Bonded Warehouse Company

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

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Practitioner of Internal Medicine
BL Price Medical Consultants, PLLC

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Chairman of the Board and Chief Executive Officer
The Blue Ridge Distributing Company, Inc.

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DFH Holdings
General Manager
Drum & Willis-Reynolds Funeral Home & Crematory

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Timmerman Manufacturing, Inc.

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President, Treasurer, General Manager and Director
Alexander Railroad Company

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Executive Vice President, Chief Operating Officer (COO)

A. Joseph Lampron, Jr.
Executive Vice President, Chief Financial Officer (CFO)

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Jeffery P. Gniadek
Senior Vice President, Area Executive – Hickory

Rafael Intriago
Senior Vice President, Metro Market Executive

Walter C. Joyce
Senior Vice President, Chief Technology Officer

James O. Perry
Senior Vice President, Chief Retail Officer

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Senior Vice President, Area Executive - Triangle

Mark W. Sigmon
Senior Vice President, Area Executive – Denver

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J. LaShae Bock
First Vice President, Human Resources Director

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First Vice President, Certified Financial Planner

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First Vice President, Finance Director

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First Vice President, Director of Loan Operations

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First Vice President, Chief Internal Auditor

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First Vice President, Regional Sales Manager

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First Vice President, Compliance/Security Manager

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First Vice President, Regional Sales Manager

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First Vice President, Consumer Credit Administration

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Vice President, Senior Lending Officer

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Vice President, Assistant Corporate Secretary

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Vice President, Mortgage Department Manager

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Adam P. Turbyfill
Vice President, Business Development Officer

Jennifer K. Turner
Vice President, Credit Admin Loan Review Officer

Dominick Vertorano II
Vice President, Business Center Manager - Cornelius

Peoples Bank Subsidiaries' Board of Directors and Officers

Community Bank Real Estate Solutions, LLC

Board of Directors

Robert C. Abernethy
David E. Reitzel
Dan Ray Timmerman, Sr.
Lance A. Sellers

Officers

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President
Lance A. Sellers
Vice President
John Noonan
Vice President
Krissy O. Price
Secretary
A. Joseph Lampron, Jr.
Treasurer

Peoples Investment Services, Inc.

Board of Directors

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Billy L. Price, Jr., M.D.
David C. Brown
Larry E. Robinson
Douglas S. Howard
Lance A. Sellers
William D. Cable, Sr.

Officers

Lance A. Sellers
President
David C. Brown
Vice President and Assistant Secretary
Krissy O. Price
Secretary
A. Joseph Lampron, Jr.
Treasurer

Real Estate Advisory Services, Inc.

Board of Directors

Robert C. Abernethy
Dan Ray Timmerman, Sr.
David E. Reitzel
Lance A. Sellers
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Officers

David E. Reitzel
President
Lance A. Sellers
Vice President
Bruce Meisner
Vice President
Krissy O. Price
Secretary
A. Joseph Lampron, Jr.
Treasurer

SHAREHOLDER & GENERAL INFORMATION

Annual Meeting
The Annual Meeting of Shareholders of Peoples Bancorp will be held at 11 a.m. on May 4, 2017 at Catawba Country Club located at 1154 Country Club Rd, 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 listed on the NASDAQ(National Association of Securities Dealers AutomatedQuotations) Global Market, where our symbol is PEBK.

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

Broadridge Corporate Issuer Solutions, Inc. is the Plan Administrator. For more information, one may call Peoples Bancorp at 828-464-5620 or 800-948-7195 or contact the Plan Administrator at 855-263-4988.

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.

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
Broadridge Corporate Issuer Solutions, Inc.
P.O. Box 1342
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Independent Auditors
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