PEOPLES BANCORP OF NORTH CAROLINA INC
Form DEF 14A
March 31, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

(Rule 14a-101)

Proxy Statement Pursuant to Section 14(a)

of the Securities Exchange Act of 1934

Filed by the Registrant [X]

Filed by a Party other than the Registrant [ ]

Check the appropriate box:

[ ] Preliminary Proxy Statement
[X] Definitive Proxy Statement
[ ] Definitive Additional Materials
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Peoples Bancorp of North Carolina, Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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[X]		No fee required.
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PEOPLES BANCORP
OF NORTH CAROLINA, INC.

Notice of 2008 Annual Meeting,
Proxy Statement and
Annual Report

PEOPLES BANCORP OF NORTH CAROLINA, INC.

PROXY STATEMENT

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PEOPLES BANCORP OF NORTH CAROLINA, INC.
Post Office Box 467
518 West C Street
Newton, North Carolina 28658-0467
(828) 464-5620

NOTICE OF 2008 ANNUAL MEETING OF SHAREHOLDERS
To Be Held on May 1, 2008

NOTICE IS HEREBY GIVEN that the 2008 Annual Meeting of Shareholders of Peoples Bancorp of North Carolina, Inc. (the "Company") will be held as follows:

Place:	Catawba Country Club 1154 Country Club Road Newton, North Carolina
Date:	May 1, 2008
Time:	11:00 a.m., Eastern Time

The purposes of the Annual Meeting are to consider and vote upon the following matters:

- To elect two persons who will serve as members of the Board of Directors until the 2011 Annual Meeting of Shareholders or until their successors are duly elected and qualified;
- To amend the Company's Articles of Incorporation to provide that directors be elected annually;
- To ratify the appointment of Porter Keadle Moore, LLP ("PKM") as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2008; and
- To consider and act on any other matters that may properly come before the Annual Meeting or any adjournment.

The Board of Directors has established March 10, 2008 as the record date for the determination of shareholders entitled to notice of and to vote at the Annual Meeting. If an insufficient number of shares is present in person or by proxy to constitute a quorum at the time of the Annual Meeting, the Annual Meeting may be adjourned in order to permit further solicitation of proxies by the Company.

A form of proxy is enclosed to enable you to vote your shares at the Annual Meeting. You are urged, regardless of the number of shares you hold, to complete, sign, date and return the proxy promptly. A return envelope, which requires no postage if mailed in the United States, is enclosed for your convenience.

By Order of the Board of Directors,

/s/ Tony W. Wolfe

Tony W. Wolfe
President and Chief Executive Officer

Newton, North Carolina
March 31, 2008

PEOPLES BANCORP OF NORTH CAROLINA, INC.

PROXY STATEMENT

Annual Meeting of Shareholders
To Be Held On May 1, 2008

This Proxy Statement is being mailed to our shareholders on or about March 31, 2008 for solicitation of proxies by the Board of Directors of Peoples Bancorp of North Carolina, Inc. Our principal executive offices are located at 518 West C Street, Newton, North Carolina 28658. Our telephone number is (828) 464-5620.

In this Proxy Statement, the terms "we," "us," "our" and the "Company" refer to Peoples Bancorp of North Carolina, Inc. The term "Bank" means Peoples Bank, our wholly-owned, North Carolina-chartered bank subsidiary. The terms "you" and "your" refer to the shareholders of the Company.

INFORMATION ABOUT THE ANNUAL MEETING

Your vote is very important. For this reason, our Board is requesting that you allow your common stock to be represented at the 2008 Annual Meeting of Shareholders by the proxies named on the enclosed proxy card.

When is the Annual Meeting?	May 1, 2008 at 11 a.m., Eastern Time
Where will the Annual Meeting be held?	At the Catawba Country Club, 1154 Country Club Road, Newton, North Carolina
What items will be voted on at the Annual Meeting?	1. ELECTION OF DIRECTORS. To elect two directors to serve until the 2011 Annual Meeting of Shareholders; 2. AMENDMENT OF THE ARTICLES OF INCORPORATION. To amend the Company's Articles of Incorporation to provide that directors be elected annually; 3. RATIFICATION OF REGISTERED PUBLIC ACCOUNTING FIRM. To ratify the appointment of PKM as the Company's independent registered public accounting firm for fiscal year 2008; and 4. OTHER BUSINESS. To consider any other business as may properly come before the Annual Meeting or any adjournment.

Who can vote? Only holders of record of our common stock at the close of business on March 10, 2008 (the "Record Date") will be entitled to notice of and to vote at the Annual Meeting and any adjournment of the Annual Meeting. On the Record Date, there were 5,602,329 shares of our common stock outstanding and entitled to vote and 700 shareholders of record.

How do I vote by proxy? You may vote your shares by marking, signing and dating the enclosed proxy card and returning it in the enclosed postage-paid envelope. If you return your signed proxy card before the Annual Meeting, the proxies will vote your shares as you direct. The Board of Directors has appointed proxies to represent shareholders who cannot attend the Annual Meeting in person.

For the election of directors, you may vote for (1) all of the nominees, (2) none of the nominees, or (3) all of the nominees except those you designate. If a nominee for election as a director becomes unavailable for election at any time at or before the Annual Meeting, the proxies will vote your shares for a substitute nominee. For each other item of business, you may vote "FOR" or "AGAINST" or you may "ABSTAIN" from voting.

If you return your signed proxy card but do not specify how you want to vote your shares, the proxies will vote them "FOR" the election of all of our nominees for directors and "FOR" all other proposals presented in this Proxy Statement in accordance with Board of Directors recommendations.

If your shares are held in the name of a broker or other nominee (i.e., held in "street name"), you will need to obtain a proxy instruction form from the broker holding your shares and return the form as directed by your broker.

We are not aware of any other matters to be brought before the Annual Meeting. If matters other than those discussed above are properly brought before the Annual Meeting, the proxies may vote your shares in accordance with their best judgment.

How do I change or revoke my proxy? You can change or revoke your proxy at any time before it is voted at the Annual Meeting in any of three ways: (1) by delivering a written notice of revocation to the Secretary of the Company; (2) by delivering another properly signed proxy card to the Secretary of the Company with a more recent date than your first proxy card; or (3) by attending the Annual Meeting and voting in person. You should deliver your written notice or superseding proxy to the Secretary of the Company at our principal executive offices listed above.

How many votes can I cast? You are entitled to one vote for each share held as of the Record Date on each nominee for election and each other matter presented for a vote at the Annual Meeting. You may not vote your shares cumulatively in the election of directors.

How many votes are required to approve the proposals?	If a quorum is present at the Annual Meeting, each director nominee will be elected by a plurality of the votes cast in person or by proxy. If you withhold your vote on a nominee, your shares will not be counted as having voted for that nominee.

The proposal to approve amendments to the Company's Articles of Incorporation will be approved by the affirmative vote of the holders of a majority of the shares present, or represented by proxy, at the Annual Meeting.

The proposal to ratify the appointment of the Company's independent registered public accounting firm for 2008 will be approved if the votes cast in favor exceed the votes cast in opposition.

Any other matters properly coming before the Annual Meeting for a vote will require the affirmative vote of the holders of a majority of the shares represented in person or by proxy at the Annual Meeting and entitled to vote on that matter.

Abstentions and broker non-votes are not treated as votes cast on any proposal, therefore, neither will have an effect on the vote for the election of any director, amendment to the Company's Articles of Incorporation, or the ratification of our independent registered public accounting firm.

A broker non-vote occurs when a broker does not vote on a particular matter because the broker does not have discretionary authority on that matter and has not received instructions from the owner of the shares.

In the event there are insufficient votes present at the Annual Meeting for a quorum or to approve or ratify any proposal, the Annual Meeting may be adjourned in order to permit the further solicitation of proxies.

What constitutes a "quorum" for the Annual Meeting?	A majority of the outstanding shares of our common stock entitled to vote at the Annual Meeting, present in person or represented by proxy, constitutes a quorum (a quorum is necessary to conduct business at the Annual Meeting). Your shares will be considered part of the quorum if you have voted by proxy. Abstentions, broker non-votes and votes withheld from any director nominee count as shares present at the Annual Meeting for purposes of determining a quorum.
Who pays for the solicitation of proxies?	We will pay the cost of preparing, printing and mailing materials in connection with this solicitation of proxies. In addition to solicitation by mail, our officers, directors and regular employees, as well as those of the Bank, may make solicitations personally, by telephone or otherwise without additional compensation for doing so. We reserve the right to engage a proxy solicitation firm to assist in the solicitation of proxies for the Annual Meeting. We will, upon request, reimburse brokerage firms, banks and others for their reasonable out-of-pocket expenses in forwarding proxy materials to beneficial owners of stock or otherwise in connection with this solicitation of proxies.

When are proposals for the 2009 Annual Meeting due?	To be considered either for inclusion in the proxy materials solicited by the Board of Directors for the 2009 Annual Meeting, proposals must be received by the Secretary of the Company at our principal executive offices at 518 West C Street, Newton, North Carolina 28658 (or at P.O. Box 467, Newton, North Carolina 28658-0467) no later than December 6, 2008. To be included in the proxy materials, a proposal must comply with our Bylaws, Rule 14a-8 and all other applicable provisions of Regulation 14A under the Securities Exchange Act of 1934, as amended (the "Exchange Act").

Any proposal not intended to be included in the proxy statement for the 2009 Annual Meeting, but intended to be presented at that Annual Meeting, must be received by us at our principal executive offices listed above no later than February 18, 2009.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The Securities and Exchange Act of 1934 (the "Exchange Act"), requires that any person who acquires the beneficial ownership of more than five percent of the Company's common stock notify the Securities and Exchange Commission (the "SEC") and the Company. Following is certain information, as of March 10, 2008, regarding those persons or groups who held of record, or who are known to the Company to own beneficially, more than five percent of the outstanding common stock.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership1	Percent of Class2
Christine S. Abernethy P.O. Box 820 Newton, NC 28658	646,843 3	11.55%
Tontine Partners, LP 55 Railroad Avenue, 3rd Floor Greenwich, CT 06830-6378	519,408	9.27%

1 Unless otherwise noted, all shares are owned directly of record by the named individuals, by their spouses and minor children, or by other entities controlled by the named individuals. Voting and investment power is not shared unless otherwise indicated.

2 Based upon a total of 5,602,329 shares of common stock outstanding as of the Record Date.

3 Carolina Glove Company, Inc. owns 107,604 shares of common stock. These shares are included in the calculation of Ms. Abernethy's total beneficial ownership interest. Ms. Abernethy owns approximately 50% of the stock of Carolina Glove Company, Inc. The business is operated by a family committee. Ms. Abernethy has no active day-to-day participation in the business affairs of Carolina Glove Company, Inc.

Set forth below is certain information, as of the Record Date, regarding those shares of common stock owned beneficially by each of the persons who currently serves as a member of the Board of Directors, is a nominee for election to the Board at the Annual Meeting, or is a named executive officer of the Company. Also shown is the number of shares of common stock owned by the directors and executive officers of the Company as a group.

Name and Address	Amount and Nature of Beneficial Ownership1	Percentage of Class2
James S. Abernethy Post Office Box 327 Newton, NC 28658	171,414 3	2.99%
Robert C. Abernethy Post Office Box 366 Newton, NC 28658	181,267 4	3.16%
Joseph F. Beaman, Jr. Post Office Box 467 Newton, NC 28658	32,869 5	*
William D. Cable, Sr. Post Office Box 467 Newton, NC 28658	29,897 6	*
Douglas S. Howard P.O. Box 587 Denver, NC 28037	10,403 7 *	
A. Joseph Lampron Post Office Box 467 Newton, NC 28658	19,965 8 *	
John W. Lineberger, Jr. P.O. Box 481 Lincolnton, NC 28092	2,503	*
Gary E. Matthews 210 First Avenue South Conover, NC 28613	13,519	*
Billy L. Price, Jr., M.D. 540 11th Ave. Place NW Hickory, NC 28601	2,099	*
Larry E. Robinson Post Office Box 723 Newton, NC 28658	47,113 9	*

Lance A. Sellers Post Office Box 467 Newton, NC 28658	27,402 10	*
William Gregory Terry P.O. Box 395 Conover, NC 28613	8,720 11	*
Dan Ray Timmerman, Sr. Post Office Box 1148 Conover, NC 28613	58,072 12	1.01%
Tony W. Wolfe Post Office Box 467 Newton, NC 28658	43,503 13	*
Benjamin I. Zachary Post Office Box 277 Taylorsville, NC 28681	75,632 14	1.32%
All current directors and nominees and executive officers as a group (15 people)	660,340 15, 16	11.53%

*Does not exceed one percent of the common stock outstanding.

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1 Unless otherwise noted, all shares are owned directly of record by the named individuals, by their spouses and minor children, or by other entities controlled by the named individuals. Voting and investment power is not shared unless otherwise indicated.

2 Based upon a total of 5,602,329 shares of common stock outstanding as of the Record Date and 126,748 stock options exercisable within 60 days with respect to the designated recipient(s).

3 Includes 64,038 shares of common stock owned by Alexander Railroad Company. Mr. J. Abernethy is Vice President, Secretary and Chairman of the Board of Directors of Alexander Railroad Company.

4 Includes 5,096 shares of common stock owned by Mr. R. Abernethy's spouse, for which Mr. R. Abernethy disclaims beneficial ownership.

5 Includes 26,764 shares of common stock in which Mr. Beaman has the right to acquire beneficial interest within 60 days by the exercise of stock options granted under the Omnibus Stock Ownership and Long Term Incentive Plan.

6 Includes 21,017 shares of common stock in which Mr. Cable has the right to acquire beneficial interest within 60 days by the exercise of stock options granted under the Omnibus Stock Ownership and Long Term Incentive Plan.

7 Includes 1,650 shares of common stock owned by Mr. Howard's mother over which Mr. Howard holds a power of attorney. Includes 825 shares of common stock owned by Howard Ventures, Inc. Mr. Howard is Vice President of Howard Ventures, Inc.

8 Includes 18,400 shares of common stock in which Mr. Lampron has the right to acquire beneficial interest within 60 days by the exercise of stock options granted under the Omnibus Stock Ownership and Long Term Incentive Plan.

9 Includes 6,835 shares of common stock owned by Mr. Robinson's spouse, for which Mr. Robinson disclaims beneficial ownership.

10 Includes 21,455 shares of common stock in which Mr. Sellers has the right to acquire beneficial interest within 60 days by the exercise of stock options granted under the Omnibus Stock Ownership and Long Term Incentive Plan.

11 Includes 1,650 shares of common stock owned by Drum Funeral Home, LLC. Mr. Terry is Executive Vice President of Drum Funeral Home, LLC.

12 Includes 2,722 shares of common stock owned by Timmerman Manufacturing, Inc. Mr. Timmerman is President and a Director of Timmerman Manufacturing, Inc.

13 Includes 39,112 shares of common stock in which Mr. Wolfe has the right to acquire beneficial interest within 60 days by the exercise of stock options granted under the Omnibus Stock Ownership and Long Term Incentive Plan.

14 Includes 64,038 shares of common stock owned by Alexander Railroad Company. Mr. Zachary is President, Treasurer, General Manager and a Director of Alexander Railroad Company.

15 The 64,038 shares owned by Alexander Railroad Company and attributed to Mr. J. Abernethy and Mr. Zachary are only included once in calculating this total.

16 Includes 126,748 shares of common stock in which the executive officers, as a group, have the right to acquire beneficial interest within 60 days by the exercise of stock options granted under the Omnibus Stock Ownership and Long Term Incentive Plan.

Directors James S. Abernethy and Robert C. Abernethy are brothers and are sons of Christine S. Abernethy, who owns in excess of 10% of the common stock.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires the Company's executive officers and directors, and persons who own more than ten percent of the common stock, to file reports of ownership and changes in ownership with the SEC. Executive officers, directors and greater than ten percent beneficial owners are required by SEC regulations to furnish the Company with copies of all Section 16(a) forms they file.

Based solely on a review of the copies of such forms furnished to the Company and written representations from the Company's executive officers and directors, the Company believes that during the fiscal year ended December 31, 2007, its executive officers and directors and greater than ten percent beneficial owners complied with all applicable Section 16(a) filing requirements.

PROPOSAL 1

ELECTION OF DIRECTORS

Our Board of Directors has set its number at ten members. Our current Bylaws provide that in order to be eligible for consideration at the Annual Meeting of Shareholders, all nominations of directors, other than those made by the Nominating Committee or the Board of Directors, must be in writing and must be delivered to the Secretary of the Company not less than 50 days nor more than 90 days prior to the meeting at which such nominations will be made; provided, however, that if less than 60 days' notice of the meeting is given to the shareholders, such nominations must be delivered to the Secretary of the Company not later than the close of business on the tenth day following the day on which the notice of meeting was mailed.

The following table provides information about the two nominees for election to the Board of Directors, as well as the eight continuing directors.

Name	Age on December 31, 2007	Principal Occupation During Last Five Years	Director Since	Term Expires
Douglas S. Howard	48	Vice President, Howard Ventures, Inc.; Secretary/Treasurer, Denver Equipment of Charlotte, Inc.	2004	2011
Billy L. Price, Jr., M.D.	51	Practicing Internist and Partner in Catawba Valley Internal Medicine, P.A.; Clinical Appointment, Wake Forest University School of Medicine, Department of Internal Mrdicine	2004	2011

THE BOARD OF DIRECTORS RECOMMENDS THAT YOU VOTE "FOR" ALL OF THE NOMINEES NAMED ABOVE FOR ELECTION AS DIRECTORS.

The following table gives information about our directors continuing in office.

Name	Age on December 31, 2007	Principal Occupation During Last Five Years	Director Since	Term Expires
Robert C. Abernethy	57	President, Secretary and Treasurer, Carolina Glove Company, Inc. (glove manufacturer); Secretary and Assistant Treasurer, Midstate Contractors, Inc. (paving company)	1976	2009
James S. Abernethy	53	Vice President, Carolina Glove Company, Inc. (glove manufacturer); President and Assistant Secretary, Midstate Contractors, Inc.(paving company); Vice President, Secretary and Chairman of the Board of Directors, Alexander Railroad Company	1992	2009
Larry E. Robinson	62	President and Chief Executive Officer, The Blue Ridge Distributing Company, Inc. (beer and wine distributor); Partner and Vice President, United Beverages of North Carolina, LLC (beer distributor)	1993	2009
William Gregory Terry	40	Executive Vice President, Drum & Willis-Reynolds Funeral Homes and Crematory	2004	2009
John W. Lineberger, Jr.	57	President, Lincoln Bonded Warehouse Company (commercial warehousing facility)	2004	2010
Gary E. Matthews	52	President and Director, Matthews Construction Company, Inc.	2001	2010
Dan Ray Timmerman, Sr.	60	President/CEO, Timmerman Manufacturing, Inc. (wrought iron furniture, railings and gates manufacturer)	1995	2010

Benjamin I. Zachary	51	President, Treasurer, General Manager and Director of Alexander Railroad Company	1995	2010

We have no reason to believe that any of the nominees for election will be unable or will decline to serve if elected. In the event of death or disqualification of any nominee or the refusal or inability of any nominee to serve as a director, however, the proxies will vote for the election of another person as they determine in their discretion or may allow the vacancy to remain open until filled by the Board. In no circumstance will any proxy be voted for more than two nominees who are not named in this proxy statement. Properly executed and returned proxies, unless revoked, will be voted as directed by you or, in the absence of direction, will be voted in favor of the election of the recommended nominees. An affirmative vote of a plurality of votes cast at the Annual Meeting is necessary to elect a nominee as a director.

OUR BOARD OF DIRECTORS AND ITS COMMITTEES

How often did our Board of Directors meet during 2007?

Our Board held 18 meetings during 2007. All incumbent directors attended more than 75% of the total number of meetings of the Board and its committees on which they served during the year.

What committees does our Board have?

During 2007, our Board had four standing committees, the Audit Committee, the Governance Committee, the Compensation Committee, and the Executive Committee. The voting members of these Committees are appointed by the Board annually from among its members. Certain of our executive officers also serve as non-voting, advisory members of these committees.

Governance Committee. The Governance Committee is comprised entirely of independent Directors, as defined in Rule 4200(a)(15) of the NASDAQ's listing standards. During fiscal year 2007 the following persons served on the Committee: Directors R. Abernethy, J. Abernethy, Lineberger, Robinson, Terry, and Timmerman. The Governance Committee is responsible for developing and maintaining the corporate governance policy, as well as acting as the nominating committee for the Board.

The Governance Committee, serving as the nominating committee of the Board of Directors, interviews candidates for membership to the Board of Directors, recommends candidates to the full Board, slates candidates for Director and shareholder votes, and fills any vacancies on the Board of Directors which occur between shareholder meetings. The Governance Committee's identification of candidates for Director typically results from the business interactions of the members of the Governance Committee or from recommendations received by the committee from other Directors or from Company management. The Governance Committee currently has no written policy with regard to the consideration of director candidates recommended by security holders. If a security holder recommends a director candidate to the Governance Committee, however, the Governance Committee will consider the candidate and apply the same considerations that it would to its own candidates. The recommendation of a candidate by a security holder should be made in writing, addressed to the attention of the Governance Committee at the Company's corporate headquarters. The recommendation should include a description of the candidate's background, his or her contact information, and any other information the security holder considers useful and appropriate for the Governance Committee's consideration of the candidate. The criteria which have been established by the Governance Committee as bearing on the consideration of a candidate's qualification to serve as a Director include the following: the candidate's ethics, integrity, involvement in the community, success in business, relationship with the Bank, investment in the Company, place of residence (i.e., proximity to the Bank's market area), and financial expertise.

The Governance Committee met two times during fiscal year 2007.

A copy of the Company's Governance Committee Charter, which contains the Company's and the Bank's compensation policies and nomination policies, is reviewed annually and amended as needed, by the Committee. Shareholders may obtain a copy of the charter of the Governance Committee at no cost by requesting one from the Company's Secretary at P.O. Box 467, Newton, North Carolina 28658-0467.

Compensation Committee. The Company's Compensation Committee is responsible for reviewing the Bank's salary programs and recommendations to the Company's and the Bank's board of directors regarding compensation of the executive officers. Upon recommendation from the Compensation Committee, the Company's Board of Directors ultimately determines such compensation. See the discussion under Compensation Discussion and Analysis for more information on the functions and activities of the Compensation Committee.

REPORT OF THE COMPENSATION COMMITTEE

The Board of Directors has reviewed and discussed the Compensation and Analysis presented by the Compensation Committee with management of the Company. Based on these reviews and discussions, the Board of Directors recommends including the Compensation Disclosure and Analysis in the Company's Proxy Statement and Annual Report on Form 10-K.

Robert C. Abernethy	John W. Lineberger, Jr.
Larry E. Robinson	James S. Abernethy
William G. Terry	Dan Ray Timmerman, Sr.

Executive Committee. The Executive Committee performs duties as assigned by the full Board of Directors. Actions taken by the Executive Committee must be approved by the full Board. The Executive Committee consists of Directors R. Abernethy, J. Abernethy, Lineberger, Matthews and Howard, as well as Mr. Wolfe, the President and Chief Executive Officer of the Company. It meets on an "as needed" basis and met two times during 2007.

Audit Committee. The Company has a separately designated standing audit committee which was established in accordance with Section 3(a)(58)(A) of the Exchange Act. The Committee has a written charter which is reviewed annually, and amended as needed, by the Committee. A copy of the Audit Committee Charter is available on the Bank's website (www.peoplesbanknc.com) under Investor Relations. The Audit Committee consists of Directors R. Abernethy, Howard, Matthews, Price, Timmerman and Zachary. The Board of Directors has determined that these members are independent as that term is defined in Rule 4200(a)(15) of the NASDAQ's listing standards.

The Board of Directors has determined that each member of the Audit Committee named above qualifies as an "audit committee financial expert" based on each of the member's educational background and business experience.

The Audit Committee meets at least quarterly and, among other responsibilities, oversees (i) the independent auditing of the Company; (ii) the system of internal controls that management has established; and (iii) the quarterly and annual financial information to be provided to shareholders and the Securities and Exchange Commission. The Audit Committee met eight times during the fiscal year ended December 31, 2007.

REPORT OF AUDIT COMMITTEE

The Audit Committee has reviewed and discussed the audited financial statements with management of the Company and has discussed with the independent auditors the matters required to be discussed by SAS 61 as amended (AICPA, Professional Standards, Vol. 1 AV section 380), as adopted by the Public Company Accounting Oversight Board in Rule 3200T. In addition, the Committee has received the written disclosures and the letter from the independent accountants required by Independence Standards Board Standard No. 1 as adopted by the Public Company Accounting Oversight Board in Rule 3600T, and has discussed with the independent accountant the independent accountant's independence. Based upon these reviews and discussions, the Committee recommended to the Board of Directors that the audited financial statements be included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

Robert C. Abernethy	Douglas S. Howard
Benjamin I. Zachary	Dan R. Timmerman, Sr.

Gary E. Matthews	Dr. Billy L. Price, Jr.

How can you communicate with the Board or its members?

We do not have formal procedures for shareholder communication with our Board. In general, our directors and officers are easily accessible by telephone, postal mail or e-mail. Any matter intended for your Board, or any individual director, can be directed to Tony Wolfe, our President and Chief Executive Officer or Joe Lampron, our Chief Financial Officer, at our principal executive offices 518 West C Street, Newton, North Carolina 28658. You also may direct correspondence to our Board, or any of its members, in care of the Company at the foregoing address. Your communication will be forwarded to the intended recipient unopened.

What is our policy for director attendance at Annual Meetings?

Although it is customary for all of our directors to attend Annual Meetings of Shareholders, we have no formal policy in place requiring attendance. All Board members attended our 2007 Annual Meeting of Shareholders held on May 3, 2007.

How can a shareholder nominate someone for election to the Board?

Our Bylaws provide that in order to be eligible for consideration at the Annual Meeting of Shareholders, all nominations of directors, other than those made by the Nominating Committee or the Board of Directors, must be in writing and must be delivered to the Secretary of the Company not less than fifty days nor more than ninety days prior to the meeting at which such nominations will be made; provided, however, that if less than sixty days' notice of the meeting is given to the shareholders, such nominations must be delivered to the Secretary of the Company not later than the close of business on the tenth day following the day on which the notice of meeting was mailed.

The Board may disregard any nominations that do not comply with these requirements. Upon the instruction of the Board, the inspector of voting for the Annual Meeting may disregard all votes cast for a nominee if the nomination does not comply with these requirements. Written notice of nominations should be directed to the Secretary of the Company.

Who serves on the Board of Directors of the Bank?

The Bank has ten directors currently serving on its board of directors, who are the same people who are currently Directors of the Company.

COMPENSATION DISCUSSION AND ANALYSIS

The following discussion provides an overview and analysis of our compensation program and policies with respect to our named executive officers. It is intended to help in understanding the detailed information provided in the compensation tables beginning on page 16 of this Proxy Statement.

Compensation Committee Members

All of the members of the Compensation Committee are independent as defined in Section 4200(a)(15) of the NASDAQ’s listing standards. The Board of Directors determines on an annual basis each director’s independence. The members of the Compensation Committee in fiscal year 2007 were Directors R. Abernethy, J. Abernethy, Lineberger, Robinson, Terry and Timmerman. The Compensation Committee is responsible for developing, implementing and maintaining the Company’s and the Bank’s compensation policies.

The Committee engages a compensation consultant to help evaluate the Company's compensation design, process and decisions. Tony Wolfe, President and CEO of the Company and the Bank, makes recommendations to the Committee regarding the compensation of the executive officers. Mr. Wolfe participates in the deliberations, but not in the decisions, of the Committee regarding compensation of executive officers other than himself. He does not participate in the Committee's discussion or decisions regarding his own compensation.

Objectives of Our Compensation Program

The overall objective of our compensation program is to align total compensation so that the individual executive believes it is fair and equitable and provides the highest perceived value to our shareholders and to that individual. In order to accomplish this overall objective, our compensation program is designed to: (i) attract the qualified executives necessary to meet our needs as defined by the Company's strategic plans, and (ii) retain and motivate executives whose performance supports the achievement of our long-term plans and short-term goals.

Compensation Decision Process

As of December 2006, there is a separate Compensation Committee charged with the responsibility relating to the compensation of our executive officers. To assist in making its compensation decisions, the Committee retained a consulting firm in early 2007 but was unable to develop a comfortable working relationship with the firm. In September, 2007, the Committee retained Matthews Young Management Consulting (Matthews Young) to complete the review of elements of our compensation program and to identify its strengths and weaknesses. Matthews Young is a national strategy, organization and executive compensation consulting firm with a proprietary southeastern United States database that has expertise in several industries, including financial service institutions. For 2007, Matthews Young provided market data regarding compensation practices, including salary and non-cash and cash incentive awards, of the peer financial institutions to ensure that our executive officer compensation is competitive in the marketplace. The Company competes for executive talent with national and regional banks of similar scope of operations. As a result, the Committee determined that salary, target annual cash incentive awards and long-term incentive awards for our named executive officers should be comparable to those provided by a peer group of similar sized community banks. As described below in "Elements of Compensation," we generally target the median of our peer group for the compensation of our named executive officers.

In December 2007, at the request of the Committee, Matthews Young conducted a review of total cash compensation provided to the named executive officers of banks in the following categories:

- Financial institutions in North Carolina, South Carolina and Georgia, using a regression analysis to compare to a $900 million bank,
- United States financial institutions with average assets of $500 million to $1.9 billion,
- United States community banks with average assets of $700 to $1.0 billion.

Elements of Compensation

Our compensation program consists of the following elements: (i) base salary, (ii) annual cash incentive awards, (iii) long-term equity incentive awards, (iv) supplemental retirement plans, (v) deferred compensation and (vi) other executive benefits.

Base Salary. The salaries of our named executive officers are designed to provide a reasonable level of compensation that is affordable to the Company and fair to the executive. Salaries are reviewed annually, and adjustments, if any, are made based on the review of competitive salaries in our peer group, as well as an evaluation of the individual officer's responsibilities, job scope, and individual performance. For example, we assess each officer's success in achieving budgeted earnings and return ratios, business conduct and integrity, and leadership and team building skills.

Matthews Young and the Committee reviewed salaries of chief executive officers, chief financial officers, chief credit officers, chief operating officers and chief administrative officers available within the 2007 peer group described above. Based on this review, Matthews Young and the Committee determined that our named executive officers' salaries were within a normal range around the median of comparable positions at comparable financial institutions. The 2007 base salaries for each of our named executive officers are reflected in the Summary

Compensation table on page 18 of this Proxy Statement.

While we target the median base salary of peer companies, base salaries are managed within a range around the median. All salary increases reflect the Committee's desire to maintain competitive compensation relative to the peer group.

Annual Cash Incentive Awards. We believe that annual cash incentive awards encourage our named executive officers to achieve short–term targets that are critical to achievement of our strategic plan. The following officers are eligible to receive annual cash incentive awards under our Management Incentive Plan, which provides for cash awards to participants upon achievement of certain financial objectives:

- Tony W. Wolfe, President and Chief Executive Officer
- A. Joseph Lampron, Executive Vice President and Chief Financial Officer
- Lance A. Sellers, Executive Vice President and Chief Credit Officer
- William D. Cable, Sr., Executive Vice President and Chief Operating Officer
- Joseph F. Beaman, Jr., Executive Vice President, Chief Administrative Officer and Corporate Secretary

We seek to ensure that a significant portion of each executive officer's total annual cash compensation is linked to the attainment of the annual performance objectives determined by the executive officer and the Committee under the Management Incentive Plan.

Financial Performance Objectives. For 2007, the award for Mr. Wolfe was based on return on assets (ROA), earnings per share (EPS) and return on equity (ROE). The awards for Messrs. Lampron, Sellers, Cable and Beaman included the same ROA, EPS and ROE goals along with other measures specific to their areas of responsibility. Mr. Lampron, Sellers and Cable's objectives included goals for net interest margin, efficiency ratio and core earnings. Mr. Sellers' objectives also included goals for credit quality, loan production and fee income. Mr. Beaman's objectives included performance goals for Peoples Investment Services, Inc., a subsidiary of Peoples Bank.

These performance objectives represent those metrics that we believe are necessary for the long-term growth of a high performing community bank and are agreed upon by management and the Board of Directors as part of the annual strategic planning process. ROA, EPS and ROE ratios measure our success in providing profits and returns to our shareholders. Net interest margin is a measure of the effectiveness of our asset/liability management efforts. The efficiency ratio, which reflects the ratio of noninterest expenses to the sum of net interest income and noninterest income, is an industry measure that indicates the amount of cost needed to provide $1 of revenue and is a measure of our efficiency in revenue production.

Target Levels of Performance. In addition to determining the financial measures under the Annual Incentive Plan, the Committee also determines the level of performance under those measures necessary for an award to pay out under the Annual Incentive Plan. The Committee selects "minimum," "target" and "superior" levels of performance, which reflect the percentage by which the financial measure is achieved as measured against budget. The "minimum" level is generally about 10% below the "target" level. The "minimum" level represents the level that should be relatively easy for executives to attain in the current fiscal year. In order to receive any annual incentive award under the Annual Incentive Plan, the executive officers' performance must exceed the "minimum." Performance at or below "minimum" would result in no annual incentive awards being paid to the Company's executive officers. The "target" level is equivalent to the level we have set in our annual operating budget. It represents an amount that is attainable under the assumptions used in our annual operating budget. If all objectives are met at this level, the executives' bonus will be approximately 95% of the maximum amount. The "superior" level is typically 10% greater than the "target" level, and therefore greater than the level the Company anticipates achieving in our annual operating budget. This level represents a "stretch" goal. In the past five years, there was one year (2003) where no incentive was paid, two years where the incentive was paid at or near the target (2004 and 2005) and two years (2006 and 2007) where the "superior" level was achieved.

For 2007, Messrs. Wolfe, Lampron, Sellers, Cable and Beaman were granted incentive awards under the Management Incentive Plan under which they were eligible to earn a cash payout equal to a percentage of the median salary for their individual salary grade, based upon the level of performance against the incentive goals described above. The following table reflects the dollar range of potential payouts for 2007.

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	Wolfe	Lampron	Sellers	Cable	Beaman
Minimum Level of Performance	$106,026	$44,239	$56,789	$44,239	$37,586
Target Level of Performance	$125,905	$52,533	$67,436	$52,533	$44,633
Superior Level of Performance	$132,532	$55,298	$70,986	$55,298	$46,982

In early 2008, after reviewing the year-end financial reports, the Committee determined that our named executive officers earned awards which approximated the following percentages of their individually targeted award: Mr. Wolfe, 85%; Mr. Lampron, 90%: Mr. Sellers, 95%: Mr. Cable, 95% and Mr. Beaman, 93%. Awards earned in 2007 by each of our named executive officers pursuant to the financial performance component of the Annual Incentive Plan are reflected in the Non-Equity Incentive Compensation column of the Summary Compensation table on page 18 of this Proxy Statement.

Discretionary Bonus and Service Awards. From time to time the Compensation Committee may recommend to the Board that additional bonuses be paid based on superior accomplishments during the fiscal year. These bonuses are totally discretionary as to who will receive a bonus and the amount of any such bonus. No discretionary bonuses were awarded in 2007. The Bank gives service awards to each employee and director for every five years of service with the Bank to promote longevity of service for both directors and employees. Service awards are made in the form of shares of the Company's common stock. The number of shares awarded increases with the number of years of service to the Bank.

Long-Term Equity Incentive Awards. The Company maintains the 1999 Omnibus Stock Ownership and Long Term Incentive Plan ("Omnibus Plan"), under which it is permitted to grant incentive stock options, restricted stock grants, stock appreciation rights and performance units. The purpose of the Omnibus Plan is to promote the interests of the Company by attracting and retaining employees of outstanding ability and to provide executives of the Company greater incentive to make material contributions to the success of the Company by providing them with stock-based compensation which will increase in value based upon the market performance of the common stock and/or the corporate achievement of financial and other performance objectives. No options were granted to any executive officer in 2007. The Compensation Committee is reviewing the use of long-term equity incentives, with the intent to associate the vesting of awards to the achievement of selected financial performance goals.

Under the terms of the Omnibus Plan, option exercise prices are always based upon the closing trading price of the Company's common stock on the date of grant by the Board of Directors.

Other Executive Benefits - Perquisites. The Company provides the following to our named executive officers:

- country club memberships and dues;
- expenses for spouses to attend conferences; and
- personal use of Company-provided cell phones.

Mr. Wolfe is also provided the use of a company-owned vehicle.

The aggregate cost of the above-mentioned perquisites does not equal $10,000 for any of the Company's named executive officers.

For 2007, we determined the level of perquisites and benefits to offer based on information gathered by Matthews Young and the Committee's review of other financial institutions in our market area. We believe these perquisites serve a dual purpose. They are competitive with companies in our peer group, and they also facilitate the officer's ability to work outside our corporate headquarters by assisting with travel and providing an external location to conduct business.

Other Executive Benefits - Retirement Benefits. The Company maintains supplemental executive retirement agreements (SERPs) for the benefit of Messrs. Wolfe, Lampron, Sellers, Cable and Beaman. The Committee's goal is to provide competitive retirement benefits given the restrictions on executives within tax-qualified plans. The Committee worked with Matthews Young in analyzing the possible benefits of using SERPs to address the issues of internal and external equity in terms of retirement benefits offered to all employees at the Company as a percentage of final average pay and executives in our peer group. The Committee approved supplemental retirement benefits targeting 40% of the final average pay for all named executive officers. The Committee selected a target of 40% to match such benefits offered to other employees fully participating in qualified retirement plans offered by the Company. For more information on the SERPs, see page 30 of this Proxy Statement.

Other Executive Benefits - Severance Benefits. The Company has employment agreements with our named executive officers which provide, among other things, for severance benefits upon certain types of employment terminations. We believe employment agreements serve a number of functions, including (i) retention of our executive team; (ii) mitigation of any uncertainty about future employment and continuity of management in the event of a change in control; and (iii) protection of the Company and customers through non-compete and non-solicitation covenants. Additional information regarding the employment agreements, including a description of key terms and a quantification of benefits that would have been received by our named executive officers had they incurred a termination of employment on December 31, 2007, may be found on page 20 of this Proxy Statement.

Tax Deductibility of Executive Compensation. Section 162(m) of the Internal Revenue Code of 1986, as amended, places a limit of $1,000,000 on the amount of compensation that the Company may deduct in any one year with respect to each of its five most highly paid executive officers. Thus far, none of our named executive officers have received compensation in excess of the Section 162(m) limitation and, therefore, all compensation has been fully deductible.

Compensation Committee Interlocks and Insider Participation

No member of the Compensation Committee is now, or formerly was, an officer or employee of the Company or the Bank. None of the named executive officers serves as a member of the board of directors of another entity whose executive officers or directors serve on the Company's Board of Directors.

EXECUTIVE COMPENSATION AND BENEFITS

Director Compensation

Directors' Fees. Members of the Board of Directors receive no fees or compensation for their service. However, all members of the Board of Directors are also directors of the Bank and are compensated for that service. Directors receive a fee of $750 for each Bank board of directors meeting attended. An additional fee of $500 is paid to committee members for each committee meeting attended. In addition to these meeting fees, each director also received an annual retainer of $9,000. The Chairman of the Bank's board of directors receives as additional $250 per meeting attended and the chairpersons of each committee receive an additional $150 per meeting attended. Directors who are members of the board of directors of Real Estate Advisory Services, Inc., and Peoples Investment Services, Inc., subsidiaries of the Bank, received $500 per board meeting.

The Bank maintains a Service Recognition Program, under which directors, officers and employees are eligible for awards. Under this Program, directors, officers and employees are awarded a combination of common stock of the Company and cash, with the amount of the award based upon the length of service to the Bank. Any common stock awarded under the Program is purchased by the Bank on the open market, and no new shares are issued by the Company under the Service Recognition Program.

Directors' Stock Benefits Plan. Members of the Board of Directors are eligible to participate in the Company's Omnibus Stock Ownership and Long Term Incentive Plan (the "Omnibus Plan"). Each director has been awarded 9,737 book value shares (adjusted to reflect 10% stock dividends on April 24, 2000, March 16, 2005, and June 16, 2006 and a three-for-two stock split on June 15, 2007, as appropriate) under the Omnibus Plan. Directors J. Abernethy, R. Abernethy, Robinson, Timmerman and Zachary were awarded book value shares on September 28, 1999. The book value of the common stock on September 28, 1999, was $6.31 (as adjusted). These book value shares are now fully vested. Director Matthews was awarded book value shares upon his election to the Board of Directors on May 3, 2001. The book value of the common stock on May 3, 2001, was $7.69 (as adjusted). Mr. Matthews' book value shares are now fully vested. Directors Howard, Lineberger, Price and Terry were awarded book value shares on May 6, 2004. The book value of the common stock on May 6, 2004, was $8.64 (as adjusted). Their shares vest at a rate of 20% annually, with the first 20% vesting on May 6, 2005, and the final 20% vesting on May 6, 2009.

Directors' Deferred Compensation Plan. In January 2002, the Bank established a non-qualified deferred compensation plan for all of its directors. The Bank's directors are also directors of the Company. Under this plan, each director may defer all or a portion of his fees to the plan each year. The director may elect to invest the deferred compensation in a restricted list of eleven investment funds. The Bank may make matching contributions to the plan for the benefit of the director from time to time at the discretion of the Bank. Directors are fully vested in all amounts they contribute to the plan and in any amounts contributed by the Bank. The Bank has established a Rabbi Trust to hold the directors' accrued benefits under the plan. Plan assets are invested as directed by each director. There are no "above-market" returns provided for in this Plan.

Benefits under the plan are payable in the event of the director's death, resignation, removal, failure to be re-elected, retirement or in cases of hardship. Directors may elect to receive deferred compensation payments in one lump sum or in installments.

Directors' Supplemental Retirement Plan. In January 2002, the Bank implemented a non-qualified supplemental retirement benefits plan for all its directors. The plan is designed to provide a retirement benefit to the directors while at the same time minimizing the financial impact on the Bank's earnings. Under the Plan, the Company purchased life insurance contracts on the lives of each director. The increase in cash surrender value of the contracts constitutes the Company's contribution to the plan each year. The Bank will pay annual benefits to each director for 15 years beginning upon retirement from the Board of Directors. The Bank is the sole owner of all of the insurance contracts.

The following table reports all forms of compensation paid to or accrued for the benefit of each director during the 2007 fiscal year.

DIRECTOR COMPENSATION

Name	Fees Earned or Paid in Cash ($)	Stock Awards ($) 1	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)	Change in Pension Value and Nonqualified Deferred Compensation Earnings2	All Other Compensation ($)	Total ($)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
James S. Abernethy3	$30,600	$16,319	0	0	$1,457	0	$48,376
Robert C. Abernethy	$39,750	$15,044	0	0	$2,409	0	$57,203
Douglas S. Howard	$29,250	$17,104	0	0	$1,316	0	$47,670
John W. Lineberger, Jr.	$30,300	$17,104	0	0	$3,813	0	$51,217
Gary E. Matthews	$25,550	$15,043	0	0	$1,292	0	$41,885
Billy L. Price, Jr., M.D.	$25,300	$17,104	0	0	$1,838	0	$44,242
Larry E. Robinson	$30,050	$15,044	0	0	$4,914	0	$50,008
William Gregory Terry	$29,550	$17,104	0	0	$474	0	$47,128
Dan Ray Timmerman, Sr.	$36,650	$15,044	0	0	$4,318	0	$56,012
Benjamin I. Zachary	$26,550	$15,044	0	0	$1,320	0	$42,914

1 Stock awards represent the expense accrued by the Bank for each director under the Omnibus Stock Ownership and Long Term Incentive Plan as described on page 16, “Directors’ Stock Benefits Plan.”

2 Change in Pension Value and Nonqualified Deferred Compensation Earnings represents the expense accrued by the Bank for each director under the Directors’ Supplemental Retirement Plan as described on page 16, “Directors’ Supplemental Retirement Plan.”

3 Mr. Abernethy completed 15 years of service with the Bank in 2007. He received a service award of 60 shares of the Company’s common stock and cash for a total value of $1,275 on the grant date.

Executive Officers

The following table sets forth certain information with respect to the persons who are executive officers of either the Company or the Bank, or both.

Name	Age on December 31, 2007	Positions and Occupations During Last Five Years	Employed by the Company or the Bank Since
Tony W. Wolfe	61	President and Chief Executive Officer of the Company and the Bank	1990
Joseph F. Beaman, Jr.	58	Executive Vice President and Corporate Secretary of the Company; Executive Vice President, Chief Administrative Officer and Secretary of the Bank	1977
William D. Cable, Sr.	39	Executive Vice President and Assistant Corporate Treasurer of the Company; Executive Vice President and Chief Operating Officer of the Bank; Prior to 2002, Bank Senior Vice President - Information Services.	1995
Lance A. Sellers	45	Executive Vice President and Assistant Corporate Secretary of the Company; Executive Vice President and Chief Credit Officer of the Bank.	1998
A. Joseph Lampron	53	Executive Vice President, Chief Financial Officer and Corporate Treasurer of the Company; Executive Vice President and Chief Financial Officer of the Bank.	2001

Management Compensation

The executive officers of the Company are not paid any cash compensation by the Company. However, the executive officers of the Company also are executive officers of the Bank and receive compensation from the Bank.

The table on the following page shows, for the fiscal years ended December 31, 2007, 2006 and 2005, the cash compensation received by, as well as certain other compensation paid or accrued for those years, the Bank's Chief Executive Officer and the Bank's executive officers whose total annual salary and bonus exceeded $100,000.

Summary Compensation Table

(a)	Year (b)	Salary (c)	Bonus (d)	Stock Awards (e)	Option Awards (f)	Non-Equity Incentive Plan Compensation (g)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (h)	All Other Compensation(1) (i)	Total (j)
Tony W. Wolfe	2007	$243,269	$0	$0	$0	$111,526	$123,811	$23,374	[2] $501,980
President and Chief	2006	$227,255	$0	$0	$0	$97,043	$108,610	$21,072	$453,980
Executive Officer	2005	$215,994	$0	$0	$0	$68,019	$93,551	$19,046	$396,610
A. Joseph Lampron, Jr.	2007	$136,253	$0	$0	$0	$49,271	$13,454	$11,343	[3] $210,321
Executive Vice President,	2006	$128,069	$0	$325 [7]	$0	$52,908	$11,684	$12,007	$204,993
Chief Financial Officer	2005	$122,758	$0	$0	$0	$40,210	$10,121	$9,696	$182,785
Joseph F. Beaman, Jr.	2007	$119,269	$0	$5,000 [8]	$0	$43,257	$17,037	$12,024	[4] $196,587
Executive Vice President,	2006	$114,899	$0	$0	$0	$50,792	$14,789	$12,520	$193,000
Chief Administrative Officer	2005	$113,004	$0	$0	$0	$28,549	$12,792	$10,573	$164,918
and Corporate Secretary									
Lance A. Sellers	2007	$173,198	$0	$0	$0	$66,762	$10,555	$14,693 [5]	$265,208
Executive Vice President,	2006	$163,836	$0	$0	$0	$61,432	$9,208	$13,542	$248,018
Chief Credit Officer	2005	$156,919	$0	$0	$0	$47,985	$7,986	$12,106	$224,996
William D. Cable, Sr.	2007	$139,751	$0	$0	$0	$52,008	$3,303	$11,701	[6] $206,763
Executive Vice President,	2006	$132,231	$0	$0	$0	$52,908	$2,878	$10,609	$198,626
Chief Operating Officer	2005	$127,211	$0	$0	$0	$40,210	$2,495	$10,214	$180,130

1 Perquisites for the fiscal year did not exceed $10,000 as reported for the named employee.

2 For Mr. Wolfe, includes for 2007:$11,212 under the 401(k) plan, $3,469 premium paid for group term life insurance in excess of $50,000 and $1,812 paid for the Split Dollar Death Benefit; for 2006: $10,764 under the 401(k) plan, $3,247 premium paid for group term life insurance in excess of $50,000 and $1,719 paid for the Split Dollar Death Benefit; for 2005: $10,000 under the 401(k) plan, $1,992 premium paid for group term life insurance in excess of $50,000 and $1,668 paid for the Split Dollar Death Benefit.

3 For Mr. Lampron, includes for 2007: $7,347 under the 401(k) plan, $618 premium for the group term life insurance in excess of $50,000 and $329 paid for the Split Dollar Death Benefit; for 2006: $7,738 under the 401(k) plan, $574 premium for the group term life insurance in excess of $50,000 and $311 paid for the Split Dollar Death Benefit; 2005: $6,109 under the 401(k) plan, $541 premium for the group term life insurance in excess of $50,000 and $296 paid for the Split Dollar Death Benefit.

4 For Mr. Beaman, includes for 2007: $6,084 under the 401(k) plan, $980 premium for the group term life insurance in excess of $50,000 and $339 paid for the Split Dollar Death Benefit; for 2006: $7,236 under the 401(k) plan, $939 premium for the group term life insurance in excess of $50,000 and $325 paid for the Split Dollar Death Benefit; 2005: $5,711 under the 401(k) plan, $918 premium for the group term life insurance in excess of $50,000 and $308 paid for the Split Dollar Death Benefit.

5 For Mr. Sellers, includes for 2007: $8,643 under the 401(k) plan, $536 premium for the group term life insurance in excess of $50,000 and $308 paid for the Split Dollar Death Benefit; for 2006: $8,216 under the 401(k) plan, $336 premium for the group term life insurance in excess of $50,000 and $151 paid for the Split Dollar Death Benefit; 2005:$7,869 under the 401(k) plan, $319 premium for the group term life insurance in excess of $50,000 and $138 paid for the Split Dollar Death Benefit.

6 For Mr. Cable, includes for 2007: $7,327 under the 401(k) plan, $251 premium paid for group term life insurance in excess of $50,000 and $104 paid for the Split Dollar Death Benefit; for 2006: $6,627 under the 401(k) plan and a $233 premium paid for group term life insurance in excess of $50,000 and $76 paid for the Split Dollar Death Benefit; 2005: $6,343 under the 401(k) plan and a $222 premium paid for group term life insurance in excess of $50,000 and $73 paid for the Split Dollar Death Benefit.

7 Mr. Lampron completed five years of service with the Bank in 2006. He received a service award of eight shares of the Company’s common stock and cash for a total value on the grant date of $325.

8 Mr. Beaman completed thirty years of service with the Bank in 2007. He received a service award of 241 shares of the Company’s common stock and cash for a total value on the grant date of $5,000.

Employment Agreements

The Bank has entered into employment agreements with Tony W. Wolfe, President and Chief Executive Officer; Joseph F. Beaman, Jr., Executive Vice President, Chief Administrative Officer and Corporate Secretary; Lance A. Sellers, Executive Vice President, Chief Credit Officer and Assistant Corporate Secretary; A. Joseph Lampron, Executive Vice President, Chief Financial Officer and Corporate Treasurer; and William D. Cable, Sr., Executive Vice President, Chief Operating Officer and Assistant Corporate Treasurer, in order to establish their duties and compensation and to provide for their continued employment with the Bank. The agreements provide for an initial term of employment of three years. Commencing on the first anniversary date and continuing on each anniversary date thereafter, unless notice of a non-extension is given by either party, each agreement is automatically extended for an additional year so that the remaining term shall always be no less than two and no more than three years. The agreements also provide that the base salary shall be reviewed by the Board of Directors not less often than annually. In addition, the employment agreements provide for discretionary bonuses and participation in other management incentive, pension, profit-sharing, medical or retirement plans maintained by the Bank, as well as fringe benefits normally associated with such employee’s office. Mr. Wolfe’s agreement provides for a company automobile. The employment agreements provide that they may be terminated by the Bank for cause, as defined in the agreements, and that they may otherwise be terminated by the Bank (subject to vested rights) or by the employee.

In the event of a change in control, the term of the employment agreements shall be automatically extended for three years from the date of the change of control. For purposes of the employment agreement, a change in control generally will occur if (i) any “person” (as such term is used in Section 13(d) and 14(d) of the Exchange Act), other than a person who beneficially owned as of January 1, 1998, more than 5% of the Bank’s securities, acquires beneficial ownership of voting stock and irrevocable proxies representing 20% or more of any class of voting securities of either the Company or the Bank, (ii) the election of directors constituting more than one-half of the Board of Directors of the Company or the Bank who, prior to their election, were not nominated for election or approved by at least three-fourths of the Board of Directors of the Company as then constituted; (iii) either the Company or the Bank consolidates or merges with or into another corporation, association or entity or is otherwise reorganized, where neither the Company nor the Bank, respectively, is the surviving corporation in the transaction; or (iv) all or substantially all of the assets of either the Company or the Bank are sold or otherwise transferred to or acquired by any other entity or group.

In addition, the employee may voluntarily terminate his employment at any time following a change in control and continue to receive his base salary for the remainder of the term of the employment agreement, if, after the change in control, (i) the employee is assigned duties and/or responsibilities that are inconsistent with his position prior to the change in control or that are inconsistent with his reporting responsibilities at that time, (ii) the employee’s compensation or benefits are reduced, or (iii) the employee is transferred, without his consent, to a location which is an unreasonable distance from his current principal work location.

If there had been a change in control of the Company, or Mr. Wolfe had terminated his employment after a change in control, that was effective as of December 31, 2007, Mr. Wolfe would have been entitled to receive $1,108,162 under the terms of his employment agreement.

If there had been a change of control, or any voluntary termination of employment following a change in control under the terms of their respective employment agreements, Mr. Lampron would have been entitled to receive $597,371; Mr. Beaman, $529,837; Mr. Sellers $756,561; and Mr. Cable, $612,810.

An additional thirteen (13) middle management officers had employment agreements during 2007. The term of these agreements is until December 1, 2008, renewed annually and the agreements contain provisions similar to those discussed above.

Equity Compensation Plan Information

The following table presents the number of shares of Company common stock to be issued upon the exercise of outstanding options, warrants and rights; the weighted-average price of the outstanding options, warrants and rights and the number of options, warrants and rights remaining that may be issued under the Company's Omnibus Plan described below.

The following table presents the number of shares of Company common stock to be issued upon the exercise of outstanding options, warrants and rights; the weighted-average price of the outstanding options, warrants and rights and the number of options, warrants and rights remaining that may be issued under the Company's Omnibus Plan described below.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	195,725[1,2]	$8.38[3]	636,687[4]
Equity compensation plans not approved by security holders	0	$0	0
Total	195,725[1,2]	$8.38[3]	636,687[4]

1 Includes 192,725 stock options issued under the 1999 Omnibus Plan, which are fully vested as of December 31, 2007. Of the outstanding stock options, options to purchase a total of 18,350 shares of the common stock were granted on September 28, 1999; 20,984 options were granted on September 25, 2000; 64,399 options were granted on October 30, 2001; 7,510 options were granted on December 18, 2001; 75,431 options were granted on December 17,2002; 3,630 options were granted on May 6, 2004; and 2,421 options were granted on December 16, 2004.

2 Includes 3,000 shares of restricted stock granted on September 20, 2007 under the 1999 Omnibus Plan. These restricted stock grants cliff vest three years after issuance.

3 The exercise prices for the grants of stock options under the 1999 Omnibus Plan on September 28, 1999; September 25, 2000; October 30, 2001; December 18, 2001; December 17, 2002; May 6, 2004 and December 16, 2004 are: $9.02 (as adjusted due to a 10% stock dividend granted on April 24, 2000); $6.99; $8.78; $8.10; $7.77; $10.31; and $10.57, respectively. All prices and shares have been adjusted for the 10% stock dividends paid March 16, 2005 and June 16, 2006 and the three-for-two stock split paid June 15, 2007. The exercise price for the grants of restricted stock is $17.40.

4 The number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) reflects 390,000 additional shares approved May 3, 2007, which have been restated to 585,000 additional shares to reflect the three-for-two stock split paid June 15, 2007.

Omnibus Stock Ownership and Long Term Incentive Plan

The Board of Directors implemented the Omnibus Plan which was approved by the Company's shareholders on May 13, 1999. Last year, shareholders approved Amendment No. 1 to the Company's Omnibus Stock Option and Long Term Incentive Plan (the "Omnibus Plan"), which provided for 585,000, adjusted for the three-for-two stock split on

June 4, 2007 shares of the Company’s common stock to be added to the 1999 Omnibus Plan. These shares underlie Rights which may be granted under the Omnibus Plan. On March 20, 2008, the Board of Directors amended the 1999 Omnibus Plan to bring it into compliance with 409A of the Internal Revenue Code of 1986, as amended. Under the terms of the 1999 Omnibus Plan, these amendments did not require shareholder approval. The 1999 Omnibus Plan will expire in 2009.

General. The purpose of the Omnibus Plan is to promote the interests of the Company by attracting and retaining directors and employees of outstanding ability and to provide executive and other key employees of the Company and its subsidiaries greater incentive to make material contributions to the success of the Company by providing them with stock-based compensation which will increase in value based upon the market performance of the common stock and/or the corporate achievement of financial and other performance objectives.

The Omnibus Plan will be administered by the Governance Committee of the Board of Directors (the "Committee"). Subject to the terms of the Omnibus Plan, the Committee and the Board of Directors have authority to construe and interpret, for eligible employees and eligible directors, respectively, the Omnibus Plan, to determine the terms and provisions of Rights (as defined below) to be granted under the Omnibus Plan, to define the terms used in the Omnibus Plan and in the Rights granted thereunder, to prescribe, amend and rescind rules and regulations relating to the Omnibus Plan, to determine the individuals to whom and the times at which Rights shall be granted and the number of shares to be subject to, or to underlie, each Right awarded, and to make all other determinations necessary or advisable for the administration of the Omnibus Plan.

Rights Which May Be Granted. Under the Omnibus Plan, the Committee may grant or award eligible participants Options, rights to receive restricted shares of common stock, long term incentive units (each equivalent to one share of common stock), SARs, and/or Book Value Shares. These grants and awards are referred to herein as the "Rights." Any Rights that the Governance Committee grants must be awarded by March 30, 2009, the tenth anniversary of the date the Board of Directors adopted the Omnibus Plan. Any Rights not granted are forfeited.

Options. Options granted under the Omnibus Plan to eligible directors and employees may be either incentive stock options ("ISOs") or non-qualified stock options ("NSOs"). The exercise price of an Option may not be less than 100% of the last-transaction price for the common stock quoted by the Nasdaq Global Market on the date of grant.

The Committee shall determine the expiration date of each Option granted, up to a maximum of ten years from the date of grant. In the Committee's discretion, it may specify the period or periods of time within which each Option will first become exercisable, which period or periods may be accelerated or shortened by the Committee.

Each Option granted will terminate upon the expiration date established by the Committee or upon the earlier of (i) twelve months after the holder ceases to be an eligible employee or director by reason of death or disability, and (ii) immediately as of the date the holder is no longer an eligible employee or director for any reason other than death or disability. In the event of a change in control (as that term is defined in the Omnibus Plan), any unvested options granted under the Omnibus Plan will immediately and automatically vest.

Restricted Stock. The Committee may award Rights to acquire shares of common stock subject to certain transfer restrictions ("Restricted Stock") to eligible participants under the Omnibus Plan for such purchase price per share, if any, as the Committee, in its discretion, may determine appropriate. The Committee shall determine the expiration date for each Restricted Stock award, up to a maximum of ten years from the date of grant. In the Committee's discretion, it may specify the period or periods of time within which each Restricted Stock award will first become exercisable, which period or periods may be accelerated or shortened by the Committee. Under the terms of the Omnibus Plan, the Committee also has the discretion to pay out awards of Restricted Stock in the Company's common stock, cash or a combination of stock and cash.

Awards of Restricted Stock shall terminate in the same manner as described above in connection with the termination of Options.

Units. Under the Omnibus Plan, the Committee may grant to eligible directors and employees awards of long term incentive units, each equivalent in value to one share of common stock ("Units"). Except as otherwise provided, Units awarded may be distributed only after the end of a performance period of two or more years, as determined by the Committee, beginning with the year in which the awards are granted.

The percentage of the Units awarded that are to be distributed will depend on the level of financial and other performance goals achieved by the Company during the performance period. The Committee may adopt one or more performance categories in addition to, or in substitution for, a performance category or may eliminate all performance categories other than financial performance. All performance categories other than financial performance may not be applied in the aggregate as a factor of more than one against financial performance.

As soon as practicable after each performance period, the percentage of Units awarded that are to be distributed, based on the levels of performance achieved, will be determined and distributed to the recipients of such awards in the form of a combination of shares of common stock and cash. Units awarded, but which the recipients are not entitled to receive, will be cancelled.

In the event of the death or disability of a Unit recipient prior to the end of any performance period, the number of Units awarded for such performance period will be reduced in proportion to the number of months remaining in the performance period after the date of death or disability; and the remaining portion of the award, if any, may, in the discretion of the Committee, be adjusted based upon the levels of performance achieved prior to the date of death or disability, and distributed within a reasonable time after death or disability. In the event a recipient of Units ceases to be an eligible director or employee for any reason other than death or disability, all Units awarded, but not yet distributed, will be cancelled.

In the event of a change in control (as that term is defined in the Omnibus Plan), any outstanding Units will immediately and automatically be reduced as appropriate to reflect a shorter performance period.

An amount equal to the dividend payable on one share of common stock (a "dividend equivalent credit") will be determined and credited on the payment date to each Unit recipient's account for each Unit awarded and not yet distributed or cancelled. Such amount will be converted within the account to an additional number of Units equal to the number of shares of common stock which could be purchased at the last-transaction price of the common stock on the Nasdaq Global Market on the dividend payment date.

No dividend equivalent credits or distribution of Units may be credited or made if, at the time of crediting or distribution, (i) the regular quarterly dividend on the common stock has been omitted and not subsequently paid or there exists any default in payment of dividends on any such outstanding shares of common stock; (ii) the rate of dividends on the common stock is lower than at the time the Units to which the dividend equivalent credit relates were awarded, adjusted for certain changes; (iii) estimated consolidated net income of the Company for the twelve-month period preceding the month the dividend equivalent credit or distribution would otherwise have been made is less than the sum of the amount of the dividend equivalent credits and Units eligible for distribution under the Omnibus Plan in that month plus all dividends applicable to such period on an accrual basis, either paid, declared or accrued at the most recently paid rate, on all outstanding shares of common stock; or (iv) the dividend equivalent credit or distribution would result in a default in any agreement by which the Company is bound.

If an extraordinary event occurs during a performance period which significantly alters the basis upon which the performance levels were established, the Committee may make adjustments which it deems appropriate in the performance levels. Such events may include changes in accounting practices, tax, financial institution laws or regulations or other laws or regulations, economic changes not in the ordinary course of business cycles, or compliance with judicial decrees or other legal requirements.

Stock Appreciation Rights. The Omnibus Plan provides that the Committee may award to eligible directors and employees Rights to receive cash based upon increases in the market price of common stock over the last transaction price of the common stock on the Nasdaq Market (the "Base Price") on the date of the award. The Committee may adjust the Base Price of a SAR based upon the market value performance of the common stock in comparison with the aggregate market value performance of a selected index or at a stated annual percentage rate. The expiration date of a SAR may be no more than ten years from the date of award.

Each SAR awarded by the Committee may be exercisable immediately or may become vested over such period or periods as the Committee may establish, which periods may be accelerated or shortened in the Committee's discretion.

Each SAR awarded will terminate upon the expiration date established by the Committee, termination of the employment or directorship of the SAR recipient, or in the event of a change in control, as described above in connection with the termination of Options.

Book Value Shares. The Omnibus Plan provides that the Committee may award to eligible directors and eligible employees long term incentive units, each equivalent in value to the book value of one share of common stock on the date of award ("Book Value Shares"). The Committee shall specify the period or periods of time within which each Book Value Share will vest, which period or periods may be accelerated or shortened by the Committee. Upon redemption, the holder of a Book Value Share will receive an amount equal to the difference between the book value of the common stock at the time the Book Value Share is awarded and the book value of the common stock at the time the Book Value Share is redeemed, adjusted for the effects of dividends, new share issuances, and mark-to-market valuations of the Company's investment securities portfolio in accordance with FASB 115.

The expiration date of each Book Value Share awarded shall be established by the Committee, up to a maximum of ten years from the date of award. However, awards of Book Value Shares shall earlier terminate in the same manner as described above in connection with the termination of Options.

Adjustments. In the event the outstanding shares of the common stock are increased, decreased, changed into or exchanged for a different number or kind of securities as a result of a stock split, reverse stock split, stock dividend, recapitalization, merger, share exchange acquisition, or reclassification, appropriate proportionate adjustments will be made in (i) the aggregate number or kind of shares which may be issued pursuant to exercise of, or which underlie, Rights; (ii) the exercise or other purchase price, or Base Price, and the number and/or kind of shares acquirable under, or underlying, Rights; (iii) and rights and matters determined on a per share basis under the Omnibus Plan. Any such adjustment will be made by the Committee, subject to ratification by the Board of Directors. As described above, the Base Price of a SAR may also be adjusted by the Committee to reflect changes in a selected index. Except with regard to Units and Book Value Shares awarded under the Omnibus Plan, no adjustment in the Rights will be required by reason of the issuance of common stock, or securities convertible into common stock, by the Company for cash or the issuance of shares of common stock by the Company in exchange for shares of the capital stock of any corporation, financial institution or other organization acquired by the Company or a subsidiary thereof in connection therewith.

Any shares of common stock allocated to Rights granted under the Omnibus Plan, which Rights are subsequently cancelled or forfeited, will be available for further allocation upon such cancellation or forfeiture.

Federal Income Tax Consequences

Options. Under current provisions of the Code, the federal income tax treatment of ISOs and NSOs is different. Options granted to employees under the Omnibus Plan may be ISOs which are designed to result in beneficial tax treatment to the employee but not a tax deduction to the Company.

The holder of an ISO generally is not taxed for federal income tax purposes on either the grant or the exercise of the option. However, the optionee must include in his or her federal alternative minimum tax income any excess (the "Bargain Element") of the acquired common stock's fair market value at the time of exercise over the exercise price paid by the optionee. Furthermore, if the optionee sells, exchanges, gives or otherwise disposes of such common stock (other than in certain types of transactions) either within two years after the option was granted or within one year after the option was exercised (an "Early Disposition"), the optionee generally must recognize the Bargain Element as compensation income for regular federal income tax purposes. Any gain realized on the disposition in excess of the Bargain Element is subject to recognition under the usual rules applying to dispositions of property. If a taxable sale or exchange is made after such holding periods are satisfied, the difference between the exercise price and the amount realized upon the disposition of the common stock generally will constitute a capital gain or loss for tax purposes.

Options granted to directors under the Omnibus Plan would be "NSOs." In general, the holder of an NSO will recognize at the time of exercise of the NSO, compensation income equal to the amount by which the fair market value of the common stock received on the date of exercise exceeds the sum of the exercise price and any amount paid for the NSO.

If an optionee exercises an ISO or NSO and delivers shares of common stock as payment for part or all of the exercise price of the stock purchased (the “Payment Stock”), no gain or loss generally will be recognized with respect to the Payment Stock; provided, however, if the Payment Stock was acquired pursuant to the exercise of an ISO, the optionee will be subject to recognizing as compensation income the Bargain Element on the Payment Stock as an Early Disposition if the exchange for the new shares occurs prior to the expiration of the holding periods for the Payment Stock.

The Company generally would not recognize gain or loss or be entitled to a deduction upon either the grant of an ISO or NSO or the optionee's exercise of an ISO. The Company generally will recognize gain or loss or be entitled to a deduction upon the exercise of an NSO. If there is an Early Disposition, the Company generally would be entitled to deduct the Bargain Element as compensation paid to the optionee.

The above and other descriptions of federal income tax consequences are necessarily general in nature and do not purport to be complete. Moreover, statutory provisions are subject to change, as are their interpretations, and their application may vary in individual circumstances. Such descriptions may not be used to avoid any federal tax penalty. Such descriptions are written to support this proxy statement. Each taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor. Finally, the consequences under applicable state and local income tax laws may not be the same as under the federal income tax laws

Restricted Stock. Pursuant to Section 83 of the Code, recipients of Restricted Stock awards under the Omnibus Plan will recognize ordinary income in an amount equal to the fair market value of the shares of common stock granted to them at the time that the shares vest and become transferable. The Company will be entitled to deduct as a compensation expense for tax purposes the same amounts recognized as income by recipients of Restricted Stock awards in the year in which such amounts are included in income.

Units. The Company expects that participants generally will not be taxed on the award of Units. Instead, any cash and the then fair market value of any common stock received by the participants upon the distribution of a Unit generally will be taxable to the participants as compensation income upon such distribution. At that time, the Company generally will be entitled to claim a deduction in an amount equal to the compensation income.

SARs. Pursuant to Section 83 of the code, recipients of SARs under the Omnibus Plan will recognize, at the time a SAR award is exercised, ordinary income in an amount equal to the difference between the fair market value of the common stock at the time of award of the SAR and the fair market value of the common stock at the time that the SAR is exercised. The Company will be entitled to deduct as a compensation expense for tax purposes the same amounts recognized as income by recipients of SAR awards in the year in which such amounts are included in income.

Book Value Shares. The Company expects that participants generally will not be taxed on the award of Book Value Shares. Instead, any cash received by the participants upon redemption of the Book Value Shares generally will be taxable to the participant as compensation income upon distribution. At that time, the Company generally will be entitled to claim a deduction in an amount equal to the compensation income.

Incentive Compensation Plans

The Bank also has a Management Incentive Plan for officers and an Employee Incentive Plan for employees of the Bank. Eligibility under the Employee Incentive Plan is granted to all employees upon ninety (90) days of service with the Bank. Participants in the Employee Incentive Plan are entitled to receive quarterly cash incentives based upon a graduated schedule indexed to attainment of corporate budget. Participants in the Management Incentive Plan are recommended annually by the President and Chief Executive Officer to the Bank's Board of Directors. Each individual's incentive pool is determined by a formula which links attainment of corporate budget with attainment of individual goals and objectives. Incentives under the Management Incentive Plan are paid annually. More details about the Management Incentive Plan can be found in the Compensation and Disclosure Section of this Proxy Statement.

Grants of Plan-Based Awards. The following table gives information related to grants of plan-based awards made by the Company to the named executive officers during the 2007 fiscal year:

GRANTS OF PLAN-BASED AWARDS

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards			Estimated Future Payouts Under Equity Incentive Plan Awards			All Other Stock Awards: Number of Shares of Stock or Units (#)	All Other Option Awards: Number of Securities Under-lying Options (#)	Exercise or Base Price of Option Awards ($/Sh)	Grant Date Fair Value of Stock and Option'Awards
		Threshold ($)	Target ($)	Maximum ($)	Threshold (#)	Target (#)	Maximum (#)				
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(l)
Tony W. Wolfe	01/01/2007	$106,026	$125,905	$132,532							
A. Joseph Lampron	01/01/2007	$44,239	$52,533	$55,298							
Joseph F. Beaman, Jr.	01/01/2007	$37,586	$44,633	$46,982							
Lance A. Sellers	01/01/2007	$56,789	$67,436	$70,986							
William D. Cable, Sr.	01/01/2007	$44,239	$52,533	$55,298							

Outstanding Equity Awards at Fiscal Year End. The table below gives information related to equity awards held by the Company's named executive officers at the end of fiscal year 2007:

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END

	Option Awards					Stock Awards			
Name	Number of Securities Underlying Unexercised Options (#) Exercisable1	Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#)	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested ($)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
Tony W. Wolfe	12,989			$9.02	09/28/2009				
	17,048			$8.78	10/30/2011				
	9,075			$7.77	12/17/2012				
A. Joseph Lampron	7,510			$8.10	12/18/2011				
	10,890			$7.77	12/17/2012				
Joseph F. Beaman, Jr.	10,463			$6.99	10/25/2010				
	9,041			$8.78	10/30/2011				
	7,260			$7.77	12/17/2012				
Lance A. Sellers	2,379			$9.02	09/28/2009				
	8,750			$8.78	10/30/2011				
	12,705			$7.77	12/17/2012				
William D. Cable, Sr.	4,456			$6.99	10/25/2010				
	6,387			$8.78	10/30/2011				
	10,890			$7.77	12/17/2012				

1Securities underlying options have been adjusted for the three-for-two stock split on June 15, 2007.

OPTION EXERCISES AND STOCK VESTED

Name	Option Awards		Stock Awards	
	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise ($)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting ($)
(a)	(b)	(c)	(d)	(e)
Tony W. Wolfe	0	$0		
A. Joseph Lampron	0	$0		
Joseph F. Beaman, Jr.[1]	3,897	$63,404	241	5,000
Lance A. Sellers	2,500	$43,175		
William D. Cable, Sr.	0	$0		

1 Mr. Beaman completed 30 years of service with the Bank in 2007. He received a service award of 241 shares of the Company’s common stock and cash for a total value on the grant date of $5,000.

Deferred Compensation Plan

In January 2002, the Bank established a non-qualified deferred compensation plan for directors and certain officers. Eligible officers selected by the Bank’s board of directors may elect to contribute a percentage of their compensation to the plan. The Bank may make matching or other contributions to the plan as well, in amounts determined at the discretion of the Bank. Participants are fully vested in all amounts contributed to the plan by them or on their behalf.

Benefits under the plan are payable in the event of the participant’s retirement, death, termination, or as a result of hardship. Benefit payments may be made in a lump sum or in installments, as selected by the participant.

The Bank has established a Rabbi Trust to hold the accrued benefits of the participants under the plan.

NONQUALIFIED DEFERRED COMPENSATION

Name	Executive Contributions in Last FY ($)	Registrant Contributions in Last FY ($)	Aggregate Earnings in Last FY ($)	Aggregate Withdrawals/ Distributions ($)	Aggregate Balance at Last FYE ($)
(a)	(b)	(c)	(d)	(e)	(f)
Tony W. Wolfe	$9,731	$0			
A. Joseph Lampron	$4,135	$0			
Joseph F. Beaman, Jr.	$1,214	$0			
Lance A. Sellers	$0	$0			
William D. Cable, Sr.	$15,446	$0			

Supplemental Retirement Plan

In January 2002, the Bank implemented a non-qualified supplemental retirement benefits plan ("SERP") for certain officers. The plan is designed to provide a retirement benefit to the officers while at the same time minimizing the financial impact on the Bank's earnings. Under the Plan, the Company purchased life insurance contracts on the lives of certain officers. The increase in cash surrender value of the contracts constitutes the Company's contribution to the plan each year. The Bank will pay benefits to participating officers for a period between ten years and the life of the officer. The Bank is the sole owner of all of the insurance contracts.

PENSION BENEFITS

Name	Plan Name	Number of Years Credited Service (#)	Present Value of Accumulated Benefit ($)	Payments During Last Fiscal Year ($)
(a)	(b)	(c)	(d)	(e)
Tony W. Wolfe	SERP	5	$544,235	0
A. Joseph Lampron	SERP	5	$66,249	0
Joseph F. Beaman, Jr.	SERP	5	$76,519	0
Lance A. Sellers	SERP	5	$59,151	0
William D. Cable, Sr.	SERP	5	$20,688	0

Discretionary Bonuses and Service Awards

In the past, the Bank has paid bonuses to its employees in amounts determined in the discretion of the Bank's board of directors. The Bank anticipates that discretionary bonuses will continue to be paid to its employees in the future. The Bank also gives service awards to each employee for every five years of service with the Bank. Service awards are made in the form of shares of the Company's common stock. The number of shares awarded increases with the years of service to the Bank.

Profit Sharing Plan and 401(k) Plan

The Bank has a Profit Sharing Plan and 401(k) Plan for all eligible employees. The Bank made no contribution to the Profit Sharing Plan for the year ended December 31, 2007. No investments in Bank stock have been made by the plan.

Under the Bank's 401(k) plan, the Bank matches employee contributions to a maximum of five percent of annual compensation. The Bank's 2007 contribution to the 401(k) Plan pursuant to this formula was approximately $424,000. All contributions to the 401(k) Plan are tax deferred.

The Profit Sharing Plan and 401(k) Plan permit participants to choose from ten investment funds which are selected by a committee comprised of senior management. Both the 401(k) Plan and Profit Sharing Plan were amended in 2000 to permit participation in the plans beginning in the second month of employment. Both plans provide for vesting of 20% of the benefit after two years employment and 20% each year thereafter until participants are 100% vested after six years employment.

Indebtedness of and Transactions with Management and Directors

The Company is a "listed issuer" under the rules and regulations of the Exchange Act whose common stock is listed on NASDAQ. The Company uses the definition of independence contained in NASDAQ's listing standards to determine the independence of its directors and that the Board of Directors and each standing committee of the Board is in compliance with NASDAQ listing standards for independence.

Certain directors and executive officers of the Bank and their immediate families and associates were customers of and had transactions with the Bank in the ordinary course of business during 2007. All outstanding loans, extensions of credit or overdrafts, endorsements and guarantees outstanding at any time during 2007 (i) were made in the ordinary course of business, (ii) were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons, and (iii) were transactions which in the opinion of management of the Bank did not involve more than the normal risk of collectibility or present other unfavorable features.

The Bank leases two of its facilities from Shortgrass Associates, L.L.C. (AShortgrass@). Director John W. Lineberger, Jr., owns 25% of the membership interests in Shortgrass. Pursuant to the terms of the leases for the two facilities leased by the Bank, during 2007 the Bank paid a total of $186,905 to Shortgrass in lease payments for these facilities. Each of the facilities is subject to a 20-year lease between the Bank and Shortgrass. The Board of Directors routinely, and no less than annually, reviews all transactions, direct and indirect, between the Company or the Bank and any employee or director, or any of such person's immediate family members. Transactions are reviewed as to comparable market values for similar transactions. All material facts of the transactions and the director's interest are discussed by all disinterested directors and a decision made about whether the transaction is fair to the Company and the Bank. A majority vote of all disinterested directors is required to approve the transaction.

The Board of Directors also evaluates the influence family relationships may have on the independence of directors who are related by blood or marriage. Christine S. Abernethy, a greater than ten percent shareholder of the Company, has two sons, Robert C. Abernethy and James S. Abernethy, who serve on the Board of Directors. All of the non-related directors have determined that the family relationships among Christine S. Abernethy, James S. Abernethy and Robert C. Abernethy do not affect the brothers' independence as directors.

PERFORMANCE GRAPH

The following graph compares the Company’s cumulative shareholder return on its common stock with a NASDAQ index and with a southeastern bank index. The graph was prepared by SNL Securities, L.C., Charlottesville, Virginia, using data as of December 31, 2007.

COMPARISON OF SIX-YEAR CUMULATIVE TOTAL RETURNS
Performance Report for
Peoples Bancorp of North Carolina, Inc.

PROPOSAL 2

APPROVAL TO AMEND THE COMPANY'S ARTICLES OF INCORPORATION

The Board of Directors recommends that the Company's Articles of Incorporation be amended to eliminate the classified structure of the Company's Board and allow for the annual election of the directors. Article VIII, Section 8.1 of the Articles of Incorporation provides that any time the total number of directors exceeds nine or more, the directors will be divided into three classes and each class of directors will be elected for three year terms. This Proposal would amend the Company's Articles to provide that in the future years, all directors would be elected each year at the Annual Meeting of Shareholders. Current directors, including the directors elected at the 2008 Annual Meeting, would continue to serve for their elected terms. Thus, beginning with the Annual Meeting of Shareholders in the year 2011, all directors would be elected annually. The proposed amendment is attached as Appendix B to this Proxy Statement.

Under Sections 55-10-20 and 55-10-03 of the North Carolina Business Corporation Act, the adoption of the amendments to the Articles requires the affirmative vote of the holders of a majority of the outstanding shares of the Company's common stock entitled to vote at an Annual Meeting.

Classified or staggered boards have been widely adopted and have a long history in corporate law. Classified boards have been viewed as a means of promoting stability and continuity of experience on a board of directors primarily because the majority of directors at any given time will have had at least one year of experience on the board, thus assisting a company in its long-term strategic planning efforts. Also, because it would take at least two elections for a potential acquiror to gain control of a classified board without the cooperation of the board, the existence of a classified structure has been considered as possibly enhancing shareholder value by making it more likely that a party seeking to gain control of a target company will engage in arm's-length discussions with the target's existing board instead of launching a proxy fight in an attempt to gain control of the board and take over the company.

However, many investors and others have come to view a classified board structure as having the effect of reducing the accountability of directors because classified boards limit the ability of shareholders to evaluate and elect all directors on an annual basis. The election of directors is the primary means for shareholders to influence corporate governance policies and to hold management accountable for the implementation of these policies. Opponents of classified boards also believe that they discourage takeover proposals and proxy contests that could have the effect of increasing shareholder value. In light of these views, a number of major corporations have determined that principles of good corporate governance dictate that all directors of a corporation should be elected annually.

After considering the advantages and disadvantages of the classified board structure, the Board of Directors has voted to propose to the shareholders that the Company's directors be elected annually. In reaching this determination, the Board concluded that the benefits of a classified board structure were outweighed by the following considerations:

- Annual voting for directors enables the Company's shareholders to register their views on the collective performance of the Board of Directors and on each director individually which will further the Company's goal of ensuring that its corporate governance policies conform to current best practices and maximize accountability to the shareholders;

- Because there is no limit to the number of terms an individual may serve (other than an age limitation), the continuity and stability of Board membership should not be materially affected by declassification of the Company Board; and

- Even though annual election of directors may enhance the ability of a third party to acquire control of the Company without engaging in arm's-length discussions with the Board, there are other factors, such as the requirement of approvals of various bank and bank holding company regulators before an acquiror may exceed various levels of stock ownership, that reduce the likelihood that a third-party would be successful in taking over the Company without engaging in arm's-length discussions with the Board of Directors.

THE BOARD RECOMMENDS THAT THE SHAREHOLDERS VOTE “FOR” THE AMENDMENT TO THE ARTICLES OF INCORPORATION.

PROPOSAL 3

RATIFICATION OF SELECTION OF INDEPENDENT AUDITOR

Porter Keadle Moore, LLP, of Atlanta, Georgia (“PKM”), has been selected by the Audit Committee as the Company’s and the Bank’s independent auditor for the year ending December 31, 2008. Such selection is being submitted to the Company’s shareholders for ratification. Representatives of PKM are expected to attend the Meeting and will be afforded an opportunity to make a statement, if they so desire, and to respond to appropriate questions from shareholders.

Audit Fees

The aggregate fees billed by PKM for professional services rendered in connection with the (i) audit of the Company’s annual financial statements for 2007 and 2006; (ii) review of the financial statements included in the Company’s quarterly filings on Form 10-Q during those fiscal years; and (iii) review of the company’s internal controls over financial reporting in 2007 and 2006 were approximately $202,000 each year.

Audit Related Fees

The aggregate fees billed by PKM in 2007 and 2006 for professional services rendered for assurance and related services that are reasonably related to the performance of the audit or review of the Company’s financial statements and not included in “Audit Fees” above were approximately $19,000 and $13,000, respectively. These fees were primarily related to the audit of the Company’s profit sharing and 401(k) plan and the testing of management’s assertions regarding internal controls in accordance with the Federal Deposit Insurance Corporation Improvement Act.

Tax Fees

The aggregate fees billed in each of the last two fiscal years for professional services rendered by PKM for tax compliance, tax advice, and tax planning were approximately $25,000 and $23,000 in 2007 and 2006, respectively. These fees were primarily related to the preparation of the Company’s income tax returns, assistance with quarterly income tax estimates and preparation of Forms 5500 for various benefit plans.

All Other Fees

PKM did not bill the Company for any other fees during 2007 or 2006.

The fees billed by PKM are pre-approved by the Audit Committee of the Company in accordance with the policies and procedures for the Audit Committee set forth in the committee’s charter. The Audit Committee typically pre-approves all audit and non-audit services provided by the Company’s independent auditors and may not engage the independent auditors to perform any prohibited non-audit services. For 2007, one hundred percent (100%) of the total fees paid for audit, audit related and tax services were pre-approved. For 2006, one hundred percent (100%) of the fees for audit, audit related, and tax were pre-approved. The Audit Committee has determined that the rendering of non-audit professional services by PKM, as identified above, is compatible with maintaining PKM’s independence.

THE BOARD OF DIRECTORS RECOMMENDS THAT THE SHAREHOLDERS VOTE FOR RATIFICATION OF THE APPOINTMENT OF PKM AS INDEPENDENT AUDITOR FOR THE COMPANY AND THE BANK FOR THE FISCAL YEAR ENDING DECEMBER 31, 2008.

DATE FOR RECEIPT OF SHAREHOLDER PROPOSALS

It is presently anticipated that the 2009 Annual Meeting of Shareholders of the Company will be held on May 7, 2009. In order for shareholder proposals to be included in the Company's proxy materials for that meeting, such proposals must be received by the Secretary of the Company at the Company's principal executive office no later than December 6, 2008 and meet all other applicable requirements for inclusion in the Proxy Statement.

In the alternative, a shareholder may commence his or her own proxy solicitation and present a proposal from the floor at the 2008 Annual Meeting of Shareholders of the Company. In order to do so, the shareholder must notify the Secretary of the Company in writing, at the Company's principal executive office no later than February 18, 2009, of his or her proposal. If the Secretary of the Company is not notified of the shareholder's proposal by February 18, 2009, the Board of Directors may vote on the proposal pursuant to the discretionary authority granted by the proxies solicited by the Board of Directors for the 2009 Annual Meeting.

OTHER MATTERS

Management knows of no other matters to be presented for consideration at the Meeting or any adjournments thereof. If any other matters shall properly come before the Meeting, it is intended that the proxyholders named in the enclosed form of proxy will vote the shares represented thereby in accordance with their judgment, pursuant to the discretionary authority granted therein.

MISCELLANEOUS

The Annual Report of the Company for the year ended December 31, 2007, which includes financial statements audited and reported upon by the Company's independent auditor, is being mailed as Appendix A to this Proxy Statement; however, it is not intended that the Annual Report be deemed a part of this Proxy Statement or a solicitation of proxies.

THE FORM 10-K FILED BY THE COMPANY WITH THE SEC, INCLUDING THE FINANCIAL STATEMENTS AND SCHEDULES THERETO, WILL BE PROVIDED FREE OF CHARGE UPON WRITTEN REQUEST DIRECTED TO: PEOPLES BANCORP OF NORTH CAROLINA, INC., POST OFFICE BOX 467, 518 WEST C STREET, NEWTON, NORTH CAROLINA 28658-0467, ATTENTION: A. JOSEPH LAMPRON.

By Order of the Board of Directors,

/s/ Tony W. Wolfe

Tony W. Wolfe
President and Chief Executive Officer

Newton, North Carolina
March 31, 2008

APPENDIX A

PEOPLES BANCORP OF NORTH CAROLINA, INC.

General Description of Business

Peoples Bancorp of North Carolina, Inc. (the “Company”), was formed in 1999 to serve as the holding company for Peoples Bank (the “Bank”). The Company is a bank holding company registered with the Board of Governors of the Federal Reserve System (the “Federal Reserve”) under the Bank Holding Company Act of 1956, as amended (the “BHCA”). The Company’s principal source of income is any dividends, which are declared and paid by the Bank on its capital stock. The Company has no operations and conducts no business of its own other than owning the Bank. Accordingly, the discussion of the business which follows concerns the business conducted by the Bank, unless otherwise indicated.

The Bank, founded in 1912, is a state-chartered commercial bank serving the citizens and business interests of the Catawba Valley and surrounding communities through 19 banking offices located in Lincolnton, Newton, Denver, Catawba, Conover, Maiden, Claremont, Hiddenite, Hickory, Charlotte, Monroe and Cornelius, North Carolina. The Bank also operates a loan production office in Denver, North Carolina. In January 2008, the Bank opened a traditional banking office in Iredell County, in Mooresville, North Carolina and a Banco de la Gente office in Wake County, in Raleigh, North Carolina. At December 31, 2007, the Company had total assets of $907.3 million, net loans of $713.2 million, deposits of $693.7 million, total securities of $127.4 million, and shareholders’ equity of $70.1 million.

The Bank has a diversified loan portfolio, with no foreign loans and few agricultural loans. Real estate loans are predominately variable rate commercial property loans, which include residential development loans to commercial customers. Commercial loans are spread throughout a variety of industries with no one particular industry or group of related industries accounting for a significant portion of the commercial loan portfolio. The majority of the Bank's deposit and loan customers are individuals and small to medium-sized businesses located in the Bank's market area. The Bank’s loan portfolio also includes Individual Taxpayer Identification Number (ITIN) mortgage loans generated thorough the Bank’s Banco de le Gente offices. Additional discussion of the Bank’s loan portfolio and sources of funds for loans can be found in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” on pages A-4 through A-25 of the Annual Report, which is included in this Form 10-K as Exhibit 13.

The operations of the Bank and depository institutions in general are significantly influenced by general economic conditions and by related monetary and fiscal policies of depository institution regulatory agencies, including the Federal Reserve, the Federal Deposit Insurance Corporation (the “FDIC”) and the North Carolina Commissioner of Banks (the "Commissioner").

At December 31, 2007, the Bank employed 264 full-time equivalent employees.

The Bank is a subsidiary of the Company. The Bank has two subsidiaries, Peoples Investment Services, Inc. and Real Estate Advisory Services, Inc. Through a relationship with Raymond James Financial Services, Inc., Peoples Investment Services, Inc. provides the Bank's customers access to investment counseling and non-deposit investment products such as stocks, bonds, mutual funds, tax deferred annuities, and related brokerage services. Real Estate Advisory Services, Inc., provides real estate appraisal and real estate brokerage services.

In June 2006, the Company formed a wholly owned Delaware statutory trust, PEBK Capital Trust II (“PEBK Trust II”), which issued $20.0 million of guaranteed preferred beneficial interests in the Company’s junior subordinated deferrable interest debentures. All of the common securities of PEBK Trust II are owned by the Company. The proceeds from the issuance of the common securities and the trust preferred securities were used by PEBK Trust II to purchase $20.6 million of junior subordinated debentures of the Company, which pay a floating rate equal to three month LIBOR plus 163 basis points. The proceeds received by the Company from the sale of the junior subordinated debentures were used in December 2006 to repay the trust preferred securities issued by PEBK Trust in December 2001 and for general purposes. The debentures represent the sole asset of PEBK Trust II. PEBK Trust II is not included in the consolidated financial statements.

The trust preferred securities issued by PEBK Trust II accrue and pay quarterly at a floating rate of three-month LIBOR plus 163 basis points. The Company has guaranteed distributions and other payments due on the trust preferred securities to the extent PEBK Trust II does not have funds with which to make the distributions and other payments. The net combined effect of the trust preferred securities transaction is that the Company is obligated to make the distributions and other payments required on the trust preferred securities.

These trust preferred securities are mandatorily redeemable upon maturity of the debentures on June 28, 2036, or upon earlier redemption as provided in the indenture. The Company has the right to redeem the debentures purchased by PEBK Trust II, in whole or in part, on or after June 28, 2011. As specified in the indenture, if the debentures are redeemed prior to maturity, the redemption price will be the principal amount and any accrued but unpaid interest.

This report contains certain forward-looking statements with respect to the financial condition, results of operations and business of Peoples Bancorp of North Carolina, Inc. (the "Company"). These forward-looking statements involve risks and uncertainties and are based on the beliefs and assumptions of management of the Company and on the information available to management at the time that these disclosures were prepared. These statements can be identified by the use of words like "expect," "anticipate," "estimate" and "believe," variations of these words and other simila expressions. Readers should not place undue reliance on forward-looking statements as a number of important factors could cause actual results to differ materially from those in the forward-looking statements. Factors that could cause actual results to differ materially include, but are not limited to, (1) competition in the markets served by Peoples Bank (the "Bank"), (2) changes in the interest rate environment, (3) general national, regional or local economic conditions may be less favorable than expected, resulting in, among other things, a deterioration in credit quality and the possible impairment of collectibility of loans, (4) legislative or regulatory changes, including changes in accounting standards, (5) significant changes in the federal and state legal and regulatory environment and tax laws, (6) the impact of changes in monetary and fiscal policies, laws, rules and regulations and (7) other risks and factors identified in the Company's other filings with the Securities and Exchange Commission. The Company undertakes no obligation to update any forward-looking statements.

SELECTED FINANCIAL DATA

Dollars in Thousands Except Per Share Amounts

		2007	2006	2005	2004	2003
Summary of Operations						
Interest income	$	61,732	55,393	41,913	35,095	33,799
Interest expense		27,585	23,110	15,429	12,335	12,749
Net interest income		34,147	32,283	26,484	22,760	21,050
Provision for loan losses		2,038	2,513	3,110	3,256	6,744
Net interest income after provision for loan losses		32,109	29,770	23,374	19,504	14,306
Non-interest income		8,816	7,554	6,668	6,000	5,825
Non-interest expense		25,993	22,983	20,330	18,840	17,072
Income before taxes		14,932	14,341	9,712	6,664	3,059
Income taxes		5,340	5,170	3,381	2,233	1,055
Net income	$	9,592	9,171	6,331	4,431	2,004
Selected Year-End Balances						
Assets	$	907,262	818,948	730,280	686,348	674,032
Available for sale securities		120,968	117,581	115,158	105,598	79,460
Loans, net		713,174	643,078	559,239	527,419	542,404
Mortgage loans held for sale		-	-	2,248	3,783	587
Interest-earning assets		853,878	780,082	692,835	653,111	639,934
Deposits		693,639	633,820	582,854	556,522	549,802
Interest-bearing liabilities		718,870	650,364	576,681	553,135	550,357
Shareholders' equity	$	70,102	62,835	54,353	50,938	48,554
Shares outstanding*		5,624,234	5,745,951	5,677,328	5,689,763	5,690,392
Selected Average Balances						
Assets	$	846,836	772,585	706,843	684,385	661,077
Available for sale securities		120,296	118,137	108,690	93,770	72,072
Loans		665,379	604,427	550,545	547,753	539,559
Interest-earning assets		801,094	732,244	668,614	650,528	626,197
Deposits		659,174	605,407	570,997	558,142	533,703
Interest-bearing liabilities		665,727	613,686	563,210	553,880	540,676

Shareholders' equity	$	70,586	62,465	55,989	51,978	49,971
Shares outstanding*		5,700,860	5,701,829	5,692,290	5,707,975	5,687,642
Profitability Ratios						
Return on average total assets		1.13%	1.19%	0.90%	0.65%	0.30%
Return on average shareholders' equity		13.59%	14.68%	11.31%	8.52%	4.01%
Dividend payout ratio		24.30%	20.78%	22.34%	28.37%	62.56%
Liquidity and Capital Ratios (averages)						
Loan to deposit		100.94%	99.84%	96.42%	98.14%	101.10%
Shareholders' equity to total assets		8.34%	8.09%	7.92%	7.59%	7.56%
Per share of common stock*						
Basic net income	$	1.68	1.61	1.11	0.77	0.35
Diluted net income	$	1.65	1.58	1.09	0.77	0.35
Cash dividends	$	0.41	0.33	0.25	0.22	0.22
Book value	$	12.46	10.94	9.57	8.95	8.53

*Shares outstanding and per share computations have been retroactively restated to reflect a 10% stock dividend during first quarter 2005, a 10% stock dividend during second quarter 2006 and a 3-for-2 stock split during second quarter 2007.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion of our financial position and results of operations and should be read in conjunction with the information set forth under Item 1A Risk Factors and the Company's consolidated financial statements and notes thereto on pages A-27 through A-56.

Introduction

Management's discussion and analysis of earnings and related data are presented to assist in understanding the consolidated financial condition and results of operations of the Company, for the years ended December 31, 2007, 2006 and 2005. The Company is a registered bank holding company operating under the supervision of the Federal Reserve Board and the parent company of Peoples Bank (the "Bank"). The Bank is a North Carolina-chartered bank, with offices in Catawba, Lincoln, Alexander, Mecklenburg, Iredell and Union Counties, operating under the banking laws of North Carolina and the rules and regulations of the Federal Deposit Insurance Corporation (the "FDIC").

Overview

Our business consists principally of attracting deposits from the general public and investing these funds in loans secured by commercial real estate, secured and unsecured commercial loans and consumer loans. Our profitability depends primarily on our net interest income, which is the difference between the income we receive on our loan and investment securities portfolios and our cost of funds, which consists of interest paid on deposits and borrowed funds. Net interest income also is affected by the relative amounts of interest-earning assets and interest-bearing liabilities. When interest-earning assets approximate or exceed interest-bearing liabilities, any positive interest rate spread will generate net interest income. Our profitability is also affected by the level of other income and operating expenses. Other income consists primarily of miscellaneous fees related to our loans and deposits, mortgage banking income and commissions from sales of annuities and mutual funds. Operating expenses consist of compensation and benefits, occupancy related expenses, federal deposit and other insurance premiums, data processing, advertising and other expenses.

Our operations are influenced significantly by local economic conditions and by policies of financial institution regulatory authorities. The earnings on our assets are influenced by the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System (the "Federal Reserve"), inflation, interest rates, market and monetary fluctuations. Lending activities are affected by the demand for commercial and other types of loans, which in turn is affected by the interest rates at which such financing may be offered. Our cost of funds is influenced by interest rates on competing investments and by rates offered on similar investments by competing financial institutions in our market area, as well as general market interest rates. These factors can cause fluctuations in our net interest income and other income. In addition, local economic conditions can impact the credit risk of our loan portfolio, in that (1) local employers may be required to eliminate employment positions of individual borrowers, and small businesses and (2) commercial borrowers may experience a downturn in their operating performance and become unable to make timely payments on their loans. Management evaluates these factors in estimating its allowance for loan losses and changes in these economic factors could result in increases or decreases to the provision for loan losses.

Our business emphasis has been to operate as a well-capitalized, profitable and independent community-oriented financial institution dedicated to providing quality customer service. We are committed to meeting the financial needs of the communities in which we operate. We believe that we can be more effective in serving our customers than many of our non-local competitors because of our ability to quickly and effectively provide senior management responses to customer needs and inquiries. Our ability to provide these services is enhanced by the stability of our senior management team.

The Company qualified as an accelerated filer in accordance with Rule 12b-2 of the Securities Exchange Act of 1934, effective December 31, 2006. Therefore, the Company is subject to the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 ("SOX 404"). The Company incurred additional consulting and audit expenses in becoming compliant with SOX 404, and will continue to incur additional audit expenses to comply with SOX 404 going forward. Management does not expect expenses related to SOX 404 to have a material impact on the Company's financial statements.

The Bank opened a new office in Mecklenburg County, in Cornelius, North Carolina in June 2007and a new office in Iredell County, in Mooresville, North Carolina in January 2008. Also in January 2008, the Bank opened a new Banco de la Gente office in Wake County, in Raleigh, North Carolina in a continuing effort to serve the Latino community. While there are no additional traditional offices planned in 2008, management will consider opening at least one new traditional office in Mecklenburg or Iredell counties in the next two to three years and additional Banco de la Gente offices in other metropolitan areas in North Carolina.

Summary of Significant Accounting Policies

The consolidated financial statements include the financial statements of Peoples Bancorp of North Carolina, Inc. and its wholly owned subsidiary, Peoples Bank, along with its wholly owned subsidiaries, Peoples Investment Services, Inc. and Real Estate Advisory Services, Inc (collectively called the "Company"). All significant intercompany balances and transactions have been eliminated in consolidation.

The Company's accounting policies are fundamental to understanding management's discussion and analysis of results of operations and financial condition. Many of the Company's accounting policies require significant judgment regarding valuation of assets and liabilities and/or significant interpretation of specific accounting guidance. The following is a summary of some of the more subjective and complex accounting policies of the Company. A more complete description of the Company's significant accounting policies can be found in Note 1 of the Notes to Consolidated Financial Statements in the Company's 2007 Annual Report to Shareholders which is Appendix A to the Proxy Statement for the May 1, 2008 Annual Meeting of Shareholders.

Many of the Company's assets and liabilities are recorded using various techniques that require significant judgment as to recoverability. The collectability of loans is reflected through the Company's estimate of the allowance for loan losses. The Company performs periodic and systematic detailed reviews of its lending portfolio to assess overall collectability. In addition, certain assets and liabilities are reflected at their estimated fair value in the consolidated financial statements. Such amounts are based on either quoted market prices or estimated values derived from dealer quotes used by the Company, market comparisons or internally generated modeling techniques. The Company's internal models generally involve present value of cash flow techniques. The various techniques are discussed in greater detail elsewhere in management's discussion and analysis and the Notes to Consolidated Financial Statements.

There are other complex accounting standards that require the Company to employ significant judgment in interpreting and applying certain of the principles prescribed by those standards. These judgments include, but are not limited to, the determination of whether a financial instrument or other contract meets the definition of a derivative in accordance with Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133). For a more complete discussion of policies, see the notes to consolidated financial statements.

In June 2006, FASB issued Financial Interpretation No. 48 ("FIN 48") "Accounting for Uncertainty in Income Taxes – an interpretation of SFAS No. 109." FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the financial statements and prescribes a recognition threshold and measurement attribute for a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. This interpretation was effective for the Company beginning in January of 2007. The Company assessed the impact of FIN 48 and determined that there are no significant positions taken in the preparation of its tax return, and therefore FIN 48 did not have a material impact on its financial position or its results of operations.

In September 2006, the FASB ratified the conclusions reached by the Emerging Issues Task Force (EITF) on EITF 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements." This issue will require companies to recognize an obligation for either the present value of the entire promised death benefit or the annual "cost of insurance" required to keep the policy in force during the post-retirement years. EITF 06-4 is effective for the Company as of January 1, 2008. This standard is not expected to have a material effect on the Company's financial position, results of operations or disclosures.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements. SFAS 157 is effective for the Company as of January 1, 2008. This standard is not expected to have a material effect on the Company's financial position or results of operations.

In September 2006, the FASB issued SFAS No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans” (SFAS 158) – an amendment of FASB Statements No. 87, 88, 106 and 132(R). SFAS 158 requires employers to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. SFAS 158 requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions and includes expanded disclosures. SFAS 158 was effective for the Company as of January 1, 2007. This standard did not have a material effect on the Company's financial position, results of operations or disclosures.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS 159), which permits entities to choose to measure financial instruments and certain other instruments at fair value. SFAS 159 is effective for the Company as of January 1, 2008. The Company does not expect to choose this option for any asset or liability and therefore does not expect SFAS 159 to have a material effect on the Company's financial position, results of operations or disclosures.

Management of the Company has made a number of estimates and assumptions relating to reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare the accompanying consolidated financial statements in conformity with GAAP. Actual results could differ from those estimates.

The remainder of management's discussion and analysis of the Company's results of operations and financial position should be read in conjunction with the consolidated financial statements and related notes presented on pages A-27 through A-56.

Results of Operations

Summary. The Company reported earnings of $9.6 million in 2007, or $1.68 basic net earnings per share and $1.65 diluted net earnings per share, a 5% increase as compared to $9.2 million, or $1.61 basic net earnings per share and $1.58 diluted net earnings per share, for 2006. The Company's increase in net earnings for 2007 is primarily attributable to growth in interest-earning assets, which contributed to increases in net interest income and an increase in non-interest income. In addition, the Company had a decrease in the provision for loan losses for the year ended December 31, 2007 as compared to the same period one year ago. The increases in net interest income and non-interest income and the decrease in the provision for loan losses were partially offset by an increase in non-interest expense.

Net earnings for 2006 represented an increase of 45% as compared to 2005 net earnings of $6.3 million or $1.11 basic net earnings per share and $1.09 diluted net earnings per share. The increase in 2006 net earnings was primarily attributable to an increase in net interest income, an increase in non-interest income and a decrease in the provision for loan losses, which were partially offset by an increase in non-interest expense.

The return on average assets in 2007 was 1.13%, compared to 1.19% in 2006 and 0.90% in 2005. The return on average shareholders' equity was 13.59% in 2007 compared to 14.68% in 2006 and 11.31% in 2005.

Net Interest Income. Net interest income, the major component of the Company's net income, is the amount by which interest and fees generated by interest-earning assets exceed the total cost of funds used to carry them. Net interest income is affected by changes in the volume and mix of interest-earning assets and interest-bearing liabilities, as well as changes in the yields earned and rates paid. Net interest margin is calculated by dividing tax-equivalent net interest income by average interest-earning assets, and represents the Company's net yield on its interest-earning assets.

Net interest income was $34.1 million for 2007, or 6% over net interest income of $32.3 million in 2006. The increase was attributable to an increase in interest income due to an increase in the average outstanding balance of loans. Net interest income increased 22% in 2006 from $26.5 million in 2005.

Table 1 sets forth for each category of interest-earning assets and interest-bearing liabilities, the average amounts outstanding, the interest incurred on such amounts and the average rate earned or incurred for the years ended December 31, 2007, 2006 and 2005. The table also sets forth the average rate earned on total interest-earning assets, the average rate paid on total interest-bearing liabilities, and the net yield on average total interest-earning assets for the same periods. Yield information does not give effect to changes in fair value that are reflected as a component of shareholders' equity. Yields and interest income on tax-exempt investments have been adjusted to tax equivalent basis using an effective tax rate 38.55% for securities that are both federal and state tax exempt and an effective tax rate of 6.90% for state tax exempt securities. Non-accrual loans and the interest income that was recorded on these loans, if any, are included in the yield calculations for loans in all periods reported.

Table 1- Average Balance Table

(Dollars in Thousands)	December 31, 2007 Average Balance	Interest	Yield / Rate	December 31, 2006 Average Balance	Interest	Yield / Rate	December 31, 2005 Average Balance	Interest	Yield / Rate
Interest-earning assets:									
Loans	$ 665,379	55,109	8.28%	604,427	49,665	8.22%	550,545	37,234	6.76%
Interest rate swap agreements	-	(406)	-0.06%	-	(698)	-0.12%	-	(575)	-0.14%
Loan fees	-	698	0.10%	-	701	0.12%	-	464	0.80%
Total loans	665,379	55,401	8.33%	604,427	49,668	8.22%	550,545	37,123	6.74%
Investments - taxable	20,305	868	4.27%	29,784	1,306	4.38%	37,487	1,595	4.25%
Investments - nontaxable*	99,991	5,470	5.47%	88,353	4,642	5.25%	71,202	3,472	4.88%
Federal funds sold	7,378	383	5.19%	1,766	85	4.81%	2,272	73	3.21%
Other	8,041	444	5.52%	7,914	424	5.36%	7,108	269	3.61%
Total interest-earning assets	801,094	62,566	7.81%	732,244	56,125	7.66%	668,614	42,532	6.36%
Cash and due from banks	20,081			17,022			15,149		
Other assets	34,287			31,218			30,891		
Allowance for loan losses	(8,626)			(7,899)			(7,811)		
Total assets	$ 846,836			772,585			706,843		
Interest-bearing liabilities:									
NOW accounts	$ 79,550	1,127	1.42%	87,329	1,214	1.39%	110,852	1,468	1.32%
Regular savings accounts	18,685	54	0.29%	19,768	57	0.29%	21,205	65	0.31%
Money market accounts	87,916	2,918	3.32%	66,035	1,789	2.71%	56,858	1,112	1.96%
Time deposits	361,859	17,430	4.82%	335,092	14,189	4.23%	292,807	8,923	3.05%
FHLB borrowings	80,058	3,759	4.70%	74,082	3,588	4.84%	65,934	2,889	4.38%
Demand notes payable to U.S. Treasury	814	39	4.79%	722	34	4.71%	702	21	3.02%
Trust preferred securities	20,619	1,476	7.16%	24,878	1,963	7.89%	14,433	938	6.50%
Other	16,226	782	4.82%	5,780	276	4.78%	419	13	3.00%
Total interest-bearing liabilities	665,727	27,585	4.14%	613,686	23,110	3.77%	563,210	15,429	2.74%
Demand deposits	111,164			97,183			89,275		

Other liabilities	3,022			3,044			1,275		
Shareholders' equity	70,586			62,465			55,989		
Total liabilities and shareholder's equity	$ 850,499			776,378			709,749		
Net interest spread		$ 34,981	3.67%		33,015	3.89%		27,103	3.62%
Net yield on interest-earning assets			4.37%			4.51%			4.05%
Taxable equivalent adjustment									
Investment securities		$ 834			731			619	
Net interest income		$ 34,147			32,284			26,484	

*Includes U.S. government agency securities that are non-taxable for state income tax purposes of $74.9 million in 2007, $65.9 million in 2006 and $50.7 million in 2005. An effective tax rate of 6.90% was used to calculate the tax equivalent yield on these securities.

Changes in interest income and interest expense can result from variances in both volume and rates. Table 2 describes the impact on the Company’s tax equivalent net interest income resulting from changes in average balances and average rates for the periods indicated. The changes in interest due to both volume and rate have been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the changes in each.

Table 2 - Rate/Volume Analysis-Tax Equivalent Basis

	December 31, 2007			December 31, 2006		
(Dollars in Thousands)	Changes in average volume	Changes in average rates	Total increase (decrease)	Changes in average volume	Changes in average rates	Total increase (decrease)
Interest income:						
Loans: net of unearned income	$ 5,042	691	5,733	$ 4,030	8,515	12,545
Investments - taxable	(411)	(27)	(438)	(333)	44	(289)
Investments - nontaxable	624	204	828	869	301	1,170
Federal funds sold	281	17	298	(20)	32	12
Other	7	13	20	37	118	155
Total interest income	5,543	898	6,441	4,583	9,010	13,593
Interest expense:						
NOW accounts	(109)	22	(87)	(320)	66	(254)
Regular savings accounts	(3)	0	(3)	(4)	(4)	(8)
Money market accounts						