

NEW PEOPLES BANKSHARES INC

Form 10-K

March 19, 2013

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**United States**  
**Securities and Exchange Commission**

Washington, D.C. 20549

**FORM 10-K**

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934**

**For fiscal year ended December 31, 2012**

**Commission File Number 000-33411**

**New Peoples Bankshares, Inc.**

(Exact name of registrant as specified in its charter)

**Virginia**  
(State or other jurisdiction of

**31-1804543**  
(I.R.S. Employer

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incorporation or organization)

Identification No.)

67 Commerce Drive

Honaker, VA

24260

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code (276) 873-7000

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock \$2 Par Value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 of Section 15 (d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K Section 229.405 is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

The aggregate market value of the common stock held by non-affiliates, based on the last reported sales prices of \$1.05 per share on the last business day of the second quarter of 2012 was \$9,451,132.

The number of shares outstanding of the registrant's common stock was 21,870,843 as of March 18, 2013.

**DOCUMENTS INCORPORATED BY REFERENCE:**

The Proxy Statement for New Peoples Bankshares, Inc's 2013 Annual Meeting to Shareholders, is incorporated into Items 10 through 14 of this form 10-K.



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### **PART I**

#### **Item 1. Business General**

New Peoples Bankshares, Inc. (New Peoples) is a Virginia bank holding company headquartered in Honaker, Virginia. Prior to January 1, 2009, New Peoples was a financial holding company. Our business is conducted primarily through New Peoples Bank, Inc., a Virginia banking corporation (the Bank). The Bank has a division doing business as New Peoples Bank Financial Services which offers investment services through its broker dealer relationship with LPL Financial Services, Inc. NPB Insurance Services, Inc. (NPB Insurance) is a subsidiary of the Bank and offers insurance services only.

The Bank offers a range of banking and related financial services focused primarily on serving individuals, small to medium size businesses, and the professional community. We strive to serve the banking needs of our customers while developing personal, hometown relationships with them. Our board of directors believes that marketing customized banking services enables us to establish a niche in the financial services marketplace where we do business.

The Bank is headquartered in Honaker, Virginia and operates 23 full service offices in the southwestern Virginia counties of Russell, Scott, Washington, Tazewell, Buchanan, Dickenson, Wise, Lee, Smyth, and Bland; Mercer County in southern West Virginia and the eastern Tennessee county of Sullivan. The close proximity and mobile nature of individuals and businesses in adjoining counties and nearby cities in Virginia, West Virginia and Tennessee places these markets within our Bank's targeted trade area, as well.

We provide professionals and small and medium size businesses in our market area with responsive and technologically enabled banking services. These services include loans that are priced on a deposit relationship basis, easy access to our decision makers, and quick and innovative action necessary to meet a customer's banking needs. Our capitalization and lending limit enable us to satisfy the credit needs of a large portion of the targeted market segment. When a customer needs a loan that exceeds our lending limit, we try to find other financial institutions to participate in the loan with us.

#### **Our History**

The Bank was incorporated under the laws of the Commonwealth of Virginia on December 9, 1997 and began operations on October 28, 1998. On September 27, 2001, the shareholders of the Bank approved a plan of reorganization under which they exchanged their shares of Bank common stock for shares of New Peoples common stock. On November 30, 2001, the reorganization was completed and the Bank became New Peoples' wholly owned subsidiary.

In June 2003, New Peoples formed two new wholly-owned subsidiaries, NPB Financial Services, Inc. (currently named NPB Insurance Services, Inc.) and NPB Web Services, Inc. (NPB Web), a web design and hosting company.

NPB Insurance is a full-service insurance agency, dealing in personal and group life, health, and disability products. However, the Bank, through its division New Peoples Bank Financial services, offers fixed and variable annuities, fee based asset management and other investment products through a broker/dealer relationship with LPL Financial Services, Inc.

NPB Web is inactive.

In July 2004, NPB Capital Trust I was formed to issue \$11.3 million in trust preferred securities.

In September 2006, NPB Capital Trust 2 was formed to issue \$5.2 million in trust preferred securities.

#### **Branch Locations**

After a period of significant branch expansion between 2000 and 2008, we have consolidated some of our branch operations to improve efficiency. Currently, in addition to our headquarters in Honaker, Virginia we have 22 branches located in Abingdon, Virginia; Big Stone Gap, Virginia; Bland, Virginia; Bluefield, Virginia; Bristol, Virginia; Castlewood, Virginia; Chilhowie, Virginia; Clintwood, Virginia; Gate City, Virginia; Grundy, Virginia; Haysi, Virginia; Jonesville, Virginia; Lebanon, Virginia; Norton, Virginia; Pound, Virginia; Pounding Mill,

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Virginia; Tazewell, Virginia; Weber City, Virginia; Wise, Virginia; Bluewell, West Virginia; Princeton, West Virginia; and Kingsport, Tennessee.

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### **Our Market Areas**

Our primary market area consists of southwestern Virginia, southern West Virginia and northeastern Tennessee. Specifically, we operate in the southwestern Virginia counties of Russell, Scott, Washington, Tazewell, Buchanan, Dickenson, Wise, Lee, Smyth, and Bland; Mercer County in southern West Virginia and the eastern Tennessee counties of Sullivan and Washington (collectively, the Tri-State Area). The close proximity and transient nature of individuals and businesses in adjoining counties and nearby cities in Virginia, West Virginia and Tennessee place these markets within our bank's targeted trade area, as well.

Accessibility to Interstates I-77, I-81, I-26, I-64 and I-75 as well as major state and U.S. highways including US 19, US 23, US 58, US 460 and US 421 make the area an ideal location to serve markets in both the East and Mid-America. The area is strategically located midway between Atlanta-Pittsburgh, Charlotte-Cincinnati, and Richmond-Louisville, and is within a day's drive of more than half of the U.S. population. A regional airport located in Bristol, Tennessee serves the area for commercial flights to and from major cities in the United States. General aviation airports accommodating small jet service include Lonesome Pine Regional Airport, Wise, VA; Lee County Airport, Jonesville, VA; Tazewell County Airport, Claypool Hill, VA; Virginia Highlands Airport, Abingdon, VA; and Mercer County Airport, Bluefield, WV. Rail service providers include CSX Transportation and Norfolk Southern Railways.

The Tri-State Area has a diversified economy supported by natural resources, which include coal, natural gas, limestone, and timber; agriculture; healthcare; education; technology; manufacturing and services industries. Predominantly, the market is comprised of locally owned and operated small businesses. The area has also been named a technology corridor. Considerable investments in high-technology communications, high-speed broadband network and infrastructure have been made which has opened the area to large technology companies and future business development potential for new and existing businesses. The area is becoming known as one of the East Coast's new centers for electronic information technology, energy, education and emerging specialty manufacturing. Leaders in their industries are taking advantage of the low cost of doing business, training opportunities, available workforce and an exceptional quality of life experience for employers and employees alike.

### **Internet Site**

We have our internet banking site at [www.newpeoplesbank.com](http://www.newpeoplesbank.com). The site includes a customer service area that contains branch and ATM locations, product descriptions and current interest rates offered on deposit accounts. Customers with internet access can access account balances, make transfers between accounts, enter stop payment orders, order checks, and use an optional bill paying service.

### **Available Information**

We file annual, quarterly, and current reports, proxy statements and other information with the Securities and Exchange Commission (the SEC). Our SEC filings are filed electronically and are available to the public over the internet at the SEC's web site at [www.sec.gov](http://www.sec.gov). In addition, any document we file with the SEC can be read and copied at the SEC's public reference facilities at 100 F Street, N.E., Washington, D.C. 20549. Copies of documents can be obtained at prescribed rates by writing to the Public Reference Section of the SEC at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. We also provide a link to our filings on the SEC website, free of charge, through our internet website [www.npbankshares.com](http://www.npbankshares.com) under Investor Relations.

### **Banking Services**

*General.* We accept deposits, make consumer and commercial loans, issue drafts, and provide other services customarily offered by a commercial bank, such as business and personal checking and savings accounts, walk-up tellers, drive-in windows, and 24-hour automated teller machines. The Bank is a member of the Federal Reserve System and its deposits are insured under the Federal Deposit Insurance Act to the maximum limit.

*Loans.* Generally, we offer a full range of short-to-medium term commercial, 1-4 family residential mortgages and personal loans. Commercial loans include both secured and unsecured loans for working capital (including inventory and receivables), business expansion (including acquisition of real estate and improvements) and purchase of equipment and machinery. Consumer loans may include secured and unsecured loans for financing automobiles, home improvements, education, personal investments and other purposes.

Our lending activities are subject to a variety of lending limits imposed by state law. While differing limits apply in certain circumstances based on the type of loan or the nature of the borrower (including the borrower's relationship to the Bank), in general, the Bank is subject to a loan-to-one borrower limit of an amount equal to 15% of its capital and surplus in the case of loans which are not fully secured by readily

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marketable or other permissible types of collateral. The Bank voluntarily may choose to impose a policy limit on loans to a single borrower that is less than the legal lending limit.



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We obtain short-to-medium term commercial and personal loans through direct solicitation of business owners and continued business from existing customers. Completed loan applications are reviewed by our loan officers. As part of the application process, information is obtained concerning the income, financial condition, employment and credit history of the applicant. If commercial real estate is involved, information is also obtained concerning cash flow after debt service. Loan quality is analyzed based on the Bank's experience and its credit underwriting guidelines.

Loans by type as a percentage of total loans are as follows:

	December 31,				
	2012	2011	2010	2009	2008
Commercial, financial and agricultural	12.61%	14.35%	15.48%	15.56%	15.26%
Real estate - construction	4.66%	5.42%	7.39%	9.41%	8.96%
Real estate - mortgage	77.09%	73.79%	69.13%	66.02%	67.04%
Installment loans to individuals	5.64%	6.44%	8.00%	9.01%	8.74%
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

*Commercial Loans.* We make commercial loans to qualified businesses in our market area. Our commercial lending consists primarily of commercial and industrial loans to finance accounts receivable, inventory, property, plant and equipment. Commercial business loans generally have a higher degree of risk than residential mortgage loans, but have commensurately higher yields. Residential mortgage loans are generally made on the basis of the borrower's ability to make repayment from employment and other income and are secured by real estate whose value tends to be easily ascertainable. In contrast, commercial business loans typically are made on the basis of the borrower's ability to make repayment from cash flow from its business and are secured by business assets, such as commercial real estate, accounts receivable, equipment and inventory. As a result, the availability of funds for the repayment of commercial business loans may be substantially dependent on the success of the business itself.

Further, the collateral for commercial business loans may depreciate over time and cannot be appraised with as much precision as residential real estate. To manage these risks, our underwriting guidelines require us to secure commercial loans with both the assets of the borrowing business and other additional collateral and guarantees that may be available. In addition, we actively monitor certain measures of the borrower, including advance rate, cash flow, collateral value and other appropriate credit factors.

*Residential Mortgage Loans.* Our residential mortgage loans consist of residential first and second mortgage loans, residential construction loans, home equity lines of credit and term loans secured by first and second mortgages on the residences of borrowers for home improvements, education and other personal expenditures. We make mortgage loans with a variety of terms, including fixed and floating or variable rates and a variety of maturities.

Under our underwriting guidelines, residential mortgage loans are generally made on the basis of the borrower's ability to make repayment from employment and other income and are secured by real estate whose value tends to be easily ascertainable. These loans are made consistent with our appraisal policies and real estate lending policies, which detail maximum loan-to-value ratios and maturities.

*Construction Loans.* Construction lending entails significant additional risks, compared to residential mortgage lending. Construction loans often involve larger loan balances concentrated with single borrowers or groups of related borrowers. Construction loans also involve additional risks attributable to the fact that loan funds are advanced upon the security of property under construction, which is of uncertain value prior to the completion of construction. Thus, it is more difficult to evaluate the total loan funds required to complete a project and related loan-to-value ratios accurately. To minimize the risks associated with construction lending, loan-to-value limitations for residential, multi-family and non-residential construction loans are in place. These are in addition to the usual credit analysis of borrowers. Management feels that the loan-to-value ratios help to minimize the risk of loss and to compensate for normal fluctuations in the real estate market. Maturities for construction loans generally range from 4 to 12 months for residential property and from 6 to 18 months for non-residential and multi-family properties.

*Consumer Loans.* Our consumer loans consist primarily of installment loans to individuals for personal, family and household purposes. The specific types of consumer loans that we make include home improvement loans, debt consolidation loans and general consumer lending. Consumer loans entail greater risk than residential mortgage loans do, particularly in the case of consumer loans that are unsecured, such as lines of credit, or secured by rapidly depreciating assets such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan

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may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. The remaining deficiency often does not warrant further substantial

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collection efforts against the borrower. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans. A borrower may also be able to assert against the Bank as an assignee any claims and defenses that it has against the seller of the underlying collateral.

Our underwriting policy for consumer loans seeks to limit risk and minimize losses, primarily through a careful analysis of the borrower. In evaluating consumer loans, we require our lending officers to review the borrower's level and stability of income, past credit history and the impact of these factors on the ability of the borrower to repay the loan in a timely manner. In addition, we maintain an appropriate margin between the loan amount and collateral value.

*Deposits.* We offer a variety of deposit products for both individual and business customers. These include demand deposit, interest-bearing demand deposit, savings deposit, and money market deposit accounts. In addition, we offer certificates of deposit with terms ranging from 7 days to 60 months and individual retirement accounts with terms ranging from 12 months to 60 months.

*Investment Services.* We offer a variety of investment services for both individual and business customers. These services include fixed income products, variable annuities, mutual funds, indexed certificates of deposit, individual retirement accounts, long term care insurance, employee group benefit plans, college savings plans, financial planning, managed money accounts, and estate planning. We offer these services through our broker-dealer relationship with LPL Financial Services, Inc.

*Other Bank Services.* Other bank services include safe deposit boxes, cashier's checks, certain cash management services, direct deposit of payroll and social security checks and automatic drafts for various accounts. We offer ATM card services that can be used by our customers throughout Virginia and other regions. We also offer MasterCard and VISA credit card services through an intermediary. Electronic banking services include debit cards, internet banking, telephone banking and wire transfers.

We do not presently anticipate exercising trust powers, but we are able to provide similar services through our affiliation with LPL Financial Services, Inc.

## **Competition**

The banking business is highly competitive. We compete as a financial intermediary with other commercial banks, savings and loan associations, credit unions, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market mutual funds and other financial institutions operating in the southwestern Virginia, southern West Virginia, and eastern Tennessee market area and elsewhere. Our market area is a highly competitive, highly branched banking market.

Competition in the market area for loans to small businesses and professionals, the Bank's target market, is intense, and pricing is important. Many of our larger competitors have substantially greater resources and lending limits than we have. They offer certain services, such as extensive and established branch networks and trust services that we do not expect to provide or will not provide in the near future. Moreover, larger institutions operating in the market area have access to borrowed funds at lower costs than are available to us. Deposit competition among institutions in the market area also is strong. As a result, it is possible that we may pay above-market rates to attract deposits.

While pricing is important, our principal method of competition is service. As a community banking organization, we strive to serve the banking needs of our customers while developing personal, hometown relationships with them. As a result, we provide a significant amount of service and a range of products without the fees that customers can expect from larger banking institutions.

According to a market share report prepared by the Federal Deposit Insurance Corporation (the FDIC), as of June 30, 2012, the most recent date for which market share information is available, the Bank's deposits as a percentage of total deposits in its major market areas were as follows: Russell County, VA 27.98%, Scott County, VA 35.52%, Dickenson County, VA 27.93%, Tazewell County, VA 8.52%, Smyth County, VA 2.83%, Lee County, VA 5.24%, Buchanan County, VA 8.24%, Wise County, VA 7.90%, City of Norton, VA 14.15%, Bland County, VA 24.58%, Washington County, VA 2.65%, and the City of Bristol, VA 2.33%, Mercer County, WV 8.38%, and City of Kingsport, TN 1.37%.

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### **Employees**

As of December 31, 2012, we had 293 total employees, of which 278 were full-time employees. None of our employees are covered by a collective bargaining agreement, and we consider relations with employees to be excellent.

### **Supervision and Regulation**

*General.* As a bank holding company, we are subject to regulation under the Bank Holding Company Act of 1956, as amended ( *BHCA* ), and the examination and reporting requirements of the Board of Governors of the Federal Reserve System (the *Federal Reserve* ). We are also subject to Chapter 13 of the Virginia Banking Act, as amended ( *Virginia Act* ). As a state-chartered commercial bank, the Bank is subject to regulation, supervision and examination by the Virginia State Corporation Commission's Bureau of Financial Institutions ( *BFI* ). As a member of the Federal Reserve system, the Bank is also subject to regulation, supervision and examination by the Federal Reserve. Other federal and state laws, including various consumer protection and compliance laws, govern the activities of the Bank, such as the investments that it makes and the aggregate amount of loans that it may grant to one borrower.

The following description summarizes the most significant federal and state laws applicable to New Peoples and its subsidiaries. To the extent that statutory or regulatory provisions are described, the description is qualified in its entirety by reference to that particular statutory or regulatory provision.

*The Bank Holding Company Act.* Under the BHCA, the Federal Reserve examines New Peoples periodically. New Peoples is also required to file periodic reports and provide any additional information that the Federal Reserve may require. Activities at the bank holding company level are generally limited to:

banking, managing or controlling banks;

furnishing services to or performing services for its subsidiaries; and

engaging in other activities that the Federal Reserve has determined by regulation or order to be so closely related to banking as to be a proper incident to these activities.

Thus, the activities we can engage in are restricted as a matter of law.

With some limited exceptions, the BHCA requires every bank holding company to obtain the prior approval of the Federal Reserve before:

acquiring substantially all the assets of any bank;

acquiring direct or indirect ownership or control of any voting shares of any bank if after such acquisition it would own or control more than 5% of the voting shares of such bank (unless it already owns or controls the majority of such shares); or

merging or consolidating with another bank holding company.

As a result, our ability to engage in certain strategic activities is conditioned on regulatory approval.

In addition, and subject to some exceptions, the BHCA and the Change in Bank Control Act require Federal Reserve approval prior to any person or company acquiring control of a bank holding company as defined in the statutes and regulations. These requirements make it more difficult for control of our company to change.

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*The Virginia Act.* As a bank holding company registered with the BFI, we must provide the BFI with information concerning our financial condition, operations and management, among other reports required by the BFI. New Peoples is also examined by the BFI in addition to its Federal Reserve examinations. Similar to the BHCA, the Virginia Act requires that the BFI approve the acquisition of direct or indirect ownership or control of more than 5% of the voting shares of any Virginia bank or bank holding company like us.

*Payment of Dividends.* New Peoples is a separate legal entity that derives the majority of its revenues from dividends paid to it by its subsidiaries. The Bank is subject to laws and regulations that limit the amount of dividends it can pay. In addition, both New Peoples and the Bank are subject to various regulatory restrictions relating to the

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payment of dividends, including requirements to maintain capital at or above regulatory minimums. Banking regulators have indicated that banking organizations should generally pay dividends only if the organization's net income available to common shareholders over the past year has been sufficient to fully fund the dividends and the prospective rate of earnings retention appears consistent with the organization's capital needs, asset quality and overall financial condition. The FDIC has the general authority to limit the dividends paid by FDIC insured banks if the FDIC deems the payment to be an unsafe and unsound practice. The FDIC has indicated that paying dividends that deplete a bank's capital base to an inadequate level would be an unsound and unsafe banking practice. In October 2009, the Federal Reserve Bank of Richmond ( "Richmond FRB ") restricted the Company from paying dividends without prior approval. It is therefore highly unlikely that the Company will pay any dividends at least until the Richmond FRB's restriction is removed.

As the recession continues to impact asset quality and earnings at financial institutions as the above discussion states, the regulatory authorities have broad discretion to, and may, further restrict the payment of dividends by affected financial institutions and this could impact us.

*Capital Requirements.* The Federal Reserve has issued risk-based and leverage capital guidelines applicable to banking organizations that it supervises. Under the risk-based capital requirements, the Bank and the Company are each generally required to maintain a minimum ratio of total capital to risk-weighted assets (including certain off-balance sheet activities, such as standby letters of credit) of 8%. At least half of the total capital must be composed of Tier 1 Capital, which is defined as common equity, retained earnings and qualifying perpetual preferred stock, less certain intangibles. The remainder may consist of Tier 2 Capital, which is defined as specific subordinated debt, some hybrid capital instruments and other qualifying preferred stock and a limited amount of the loan loss allowance. These risk-based capital standards attempt to measure capital adequacy relative to the institution's risk profiles. In addition, each of the federal banking regulatory agencies has established minimum leverage capital requirements for banking organizations. Under these requirements, banking organizations must maintain a minimum ratio of Tier 1 capital to adjusted average quarterly assets of between 3% and 5%, subject to federal bank regulatory evaluation of an organization's overall safety and soundness. The principal objective of the leverage ratio is to constrain the degree to which an institution may leverage its equity capital base. In sum, the capital measures used by the federal banking regulators are:

the Total Capital ratio, which is the total of Tier 1 Capital and Tier 2 Capital;

the Tier 1 Capital ratio; and

the leverage ratio.

Under these regulations, a bank will be:

well capitalized if it has a Total Capital ratio of 10% or greater, a Tier 1 Capital ratio of 6% or greater, a leverage ratio of 5% or greater, and is not subject to any written agreement, order, capital directive, or prompt corrective action directive by a federal bank regulatory agency to meet and maintain a specific capital level for any capital measure;

adequately capitalized if it has a Total Capital ratio of 8% or greater, a Tier 1 Capital ratio of 4% or greater, and a leverage ratio of 4% or greater or 3% in certain circumstances and is not well capitalized;

undercapitalized if it has a Total Capital ratio of less than 8%, a Tier 1 Capital ratio of less than 4% or 3% in certain circumstances;

significantly undercapitalized if it has a Total Capital ratio of less than 6%, a Tier 1 Capital ratio of less than 3%, or a leverage ratio of less than 3%; or

critically undercapitalized if its tangible equity is equal to or less than 2% of average quarterly tangible assets,

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The risk-based capital standards of the Federal Reserve explicitly identify concentrations of credit risk and the risk arising from non-traditional activities, as well as an institution's ability to manage these risks, as important factors to be taken into account by the agency in assessing an institution's overall capital adequacy. The capital guidelines also provide that an institution's exposure to a decline in the economic value of its capital due to changes in interest rates be considered as a factor in evaluating a banking organization's capital adequacy. Thus, the capital level of a bank can be of regulatory concern even if it is well-capitalized under the regulatory formula and a well-capitalized bank can be required to maintain even higher capital levels based on its asset quality or other regulatory concerns.

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The regulators may take various corrective actions with respect to a financial institution considered to be capital deficient. These powers include, but are not limited to, requiring the institution to be recapitalized, prohibiting asset growth, restricting interest rates paid or dividends, requiring prior approval of capital distributions by any bank holding company that controls the institution, requiring divestiture by the institution of its subsidiaries or by the holding company of the institution itself, requiring new election of directors, and requiring the dismissal of directors and officers. As discussed above, in October 2009 the Richmond FRB imposed a prohibition on the Bank paying dividends to preserve capital. Bank holding companies can be called upon to boost their subsidiary bank's capital and to partially guarantee the institution's performance under its capital restoration plan. If this occurs, capital which otherwise would be available for holding company purposes, including possible distributions to shareholders, would be required to be downstreamed to one or more subsidiary bank. In this respect, the Richmond FRB also notified New Peoples that we must defer dividends on our trust preferred issuances which we did as of October 2009. As of December 31, 2012, the Bank was well capitalized, with a Total Capital ratio of 12.88%; a Tier 1 Capital ratio of 11.60%; and a leverage ratio 7.08%.

In addition, under the terms of the Written Agreement, both the Company and the Bank have agreed to submit capital plans to maintain sufficient capital at the Company, on a consolidated basis, and the Bank, on a stand-alone basis, and to refrain from declaring or paying dividends without prior regulatory approval. The Company has agreed that it will not take any other form of payment representing a reduction in the Bank's capital or make any distributions of interest, principal, or other sums on subordinated debentures or trust preferred securities without prior regulatory approval. The Company may not incur, increase or guarantee any debt without prior regulatory approval and has agreed not to purchase or redeem any shares of its stock without prior regulatory approval.

In December 2010, the Basel Committee released its final framework for strengthening international capital and liquidity regulation, now officially identified by the Basel Committee as Basel III. Basel III, when implemented by the U.S. banking agencies and fully phased-in, will require bank holding companies and their bank subsidiaries to maintain substantially more capital, with a greater emphasis on common equity and more complex risk-weightings of assets. In addition, these requirements are likely to substantially increase the Company's compliance costs and cause the Company's capital accounts to become more variable. At this point, the U.S. banking regulators have not decided whether, or to what extent, the Basel III requirements will apply to community banks like the Company.

*Other Safety and Soundness Regulations.* There are a number of obligations and restrictions imposed on bank holding companies and their bank subsidiaries by federal law and regulatory policy that are designed to reduce potential loss exposure to the depositors of such depository institutions and to the FDIC insurance funds in the event that the depository institution is insolvent or is in danger of becoming insolvent. For example, the Federal Reserve requires a bank holding company to serve as a source of financial strength to its subsidiary depository institutions and to commit resources to support such institutions in circumstances where it might not do so otherwise. These requirements can restrict the ability of bank holding companies to deploy their capital as they otherwise might.

*Interstate Banking and Branching.* Banks in Virginia may branch without geographic restriction. Current federal law authorizes interstate acquisitions of banks and bank holding companies without geographic limitation. Bank holding companies may acquire banks in any state without regard to state law except for state laws requiring a minimum time a bank must be in existence to be acquired. The Virginia Act generally permits out of state bank holding companies or banks to acquire Virginia banks or bank holding companies subject to regulatory approval. These laws have the effect of increasing competition in banking markets.

*Monetary Policy.* The commercial banking business is affected not only by general economic conditions but also by the monetary policies of the Federal Reserve. The Federal Reserve's monetary policies have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. In view of unsettled conditions in the national and international economy and money markets, as well as governmental fiscal and monetary policies their impact on interest rates, deposit levels, loan demand or the business and earnings of the Bank is unpredictable.

*Federal Reserve System.* Depository institutions that maintain transaction accounts or nonpersonal time deposits are subject to reserve requirements. These reserve requirements are subject to adjustment by the Federal Reserve. Because required reserves must be maintained in the form of vault cash or in a non-interest-bearing account at, or on behalf of, a Federal Reserve Bank, the effect of the reserve requirement is to reduce the amount of the institution's interest-earning assets.

*Transactions with Affiliates.* Transactions between banks and their affiliates are governed by Sections 23A and 23B of the Federal Reserve Act. These provisions restrict the amount and provide conditions with respect to loans, investments, transfers of assets and other transactions between New Peoples and the Bank.

*Loans to Insiders.* The Bank is subject to rules on the amount, terms and risks associated with loans to executive officers, directors, principal shareholders and their related interests.





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*Community Reinvestment Act.* Under the Community Reinvestment Act, depository institutions have an affirmative obligation to assist in meeting the credit needs of their market areas, including low and moderate-income areas, consistent with safe and sound banking practice. The Community Reinvestment Act emphasizes the delivery of bank products and services through branch locations in its market areas and requires banks to keep data reflecting their efforts to assist in its community's credit needs. Depository institutions are periodically examined for compliance with the Community Reinvestment Act and are periodically assigned ratings in this regard. Banking regulators consider a depository institution's Community Reinvestment Act rating when reviewing applications to establish new branches, undertake new lines of business, and/or acquire part or all of another depository institution. An unsatisfactory rating can significantly delay or even prohibit regulatory approval of a proposed transaction by a bank holding company or its depository institution subsidiaries. A bank holding company will not be permitted to become a financial holding company and no new activities authorized under the GLBA (see below) may be commenced by a holding company or by a bank financial subsidiary if any of its bank subsidiaries received less than a satisfactory rating in its latest Community Reinvestment Act examination. The Bank received a rating of Satisfactory at its last Community Reinvestment Act performance evaluation, as of August 8, 2011.

*Other Laws.* Banks and other depository institutions also are subject to numerous consumer-oriented laws and regulations. These laws, which include the Truth in Lending Act, the Truth in Savings Act, the Real Estate Settlement Procedures Act, the Electronic Funds Transfer Act, the Equal Credit Opportunity Act, the Fair and Accurate Credit Transactions Act of 2003 and the Fair Housing Act, require compliance by depository institutions with various disclosure and consumer information handling requirements. These and other similar laws result in significant costs to financial institutions and create potential liability for financial institutions, including the imposition of regulatory penalties for inadequate compliance.

*Gramm-Leach-Bliley Act of 1999.* The Gramm-Leach-Bliley Act of 1999 (GLBA) covers a broad range of issues, including a repeal of most of the restrictions on affiliations among depository institutions, securities firms and insurance companies.

For example, the GLBA permits unrestricted affiliations between banks and securities firms. It also permits bank holding companies to elect to become financial holding companies, which can engage in a broad range of financial services, including securities activities such as underwriting, dealing, investment, merchant banking, insurance underwriting, sales and brokerage activities. In order to become a financial holding company, a bank holding company and all of its affiliated depository institutions must be well-capitalized, well-managed and have at least a satisfactory Community Reinvestment Act rating. We converted to bank holding company status on January 1, 2009 from financial holding company. We believe we adequately provide the products and services our customers currently need or want as a bank holding company.

Essentially GLBA removed many of the limitations on affiliations between commercial banks and their holding companies and other financially related business that had been in place since the Depression. Recently, this effect of GLBA has been the subject of controversy and cited as one of the causes of the financial services crisis. As a result, The Dodd-Frank Act (as discussed later) addressed some of the criticized aspects of GLBA, but not in a way that would materially affect us.

The GLBA also provides that the states continue to have the authority to regulate insurance activities, but prohibits the states in most instances from preventing or significantly interfering with the ability of a bank, directly or through an affiliate, to engage in insurance sales, solicitations or cross-marketing activities.

*USA Patriot Act.* The USA Patriot Act provides for the facilitation of information sharing among governmental entities and financial institutions for the purpose of combating terrorism and money laundering. Regulatory authorities must consider the effectiveness of a financial institution's anti-money laundering activities, for example, its procedures for effective customer identification, when reviewing bank mergers and acquisitions. Various other laws and regulations require the Bank to cooperate with governmental authorities in respect to counter-terrorism activities. Although it does create a reporting obligation and cost of compliance for the Bank, the USA Patriot Act has not materially affected New Peoples' products, services or other business activities.

*Privacy and Fair Credit Reporting.* Financial institutions, such as the Bank, are required to disclose their privacy policies to customers and consumers and require that such customers or consumers be given a choice (through an opt-out notice) to forbid the sharing of nonpublic personal information about them with nonaffiliated third persons. The Bank also requires business partners with whom it shares such information to assure the Bank that they have adequate security safeguards and to abide by the redisclosure and reuse provisions of applicable law. In addition to adopting federal requirements regarding privacy, individual states are authorized to enact more stringent laws relating to the use of customer information. To date, Virginia has not done so. These privacy laws create compliance obligations and potential liability for the Bank.

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*Sarbanes-Oxley Act.* The Sarbanes-Oxley Act of 2002 (the Sarbanes-Oxley Act ) is intended to increase corporate responsibility, provide enhanced penalties for accounting and auditing improprieties by publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities law. The changes required by the Sarbanes-Oxley Act and its implementing regulations are intended to allow shareholders to monitor the performance of companies and their directors more easily and effectively.

The Sarbanes-Oxley Act generally applies to all domestic companies, such as New Peoples, that file periodic reports with the Securities and Exchange Commission ( SEC ) under the Securities Exchange Act of 1934, as amended. The Sarbanes-Oxley Act includes significant additional disclosure requirements and expanded corporate governance rules and the SEC has adopted extensive additional disclosures, corporate governance provisions and other related rules pursuant to it. New Peoples has expended, and will continue to expend, considerable time and money in complying with the Sarbanes-Oxley Act.

*Emergency Economic Stabilization Act of 2008.* EESA was enacted in response to the financial crises affecting the banking system and financial markets.

Pursuant to EESA, the Department of the Treasury implemented the Troubled Asset Relief Program Capital Purchase Program (the TARP Capital Purchase Program ) under which the Treasury agreed to make \$250 billion of capital available to U.S. financial institutions in the form of preferred stock (from the \$700 billion authorized by the EESA). Numerous requirements have been imposed on TARP participating financial institutions, particularly requirements related to executive compensation. We did not elect to apply to participate in TARP.

*Federal Deposit Insurance Corporation.* The Bank s deposits are insured by the Deposit insurance Fund, as administered by the FDIC, to the maximum amount permitted by law. In October 2008, deposits at FDIC-insured institutions temporarily became insured up to at least \$250,000 per depositor. The Dodd-Frank Act passed in 2010 made this increase permanent. In addition, it provides for unlimited federal deposit insurance until December 31, 2012 for non-interest bearing transaction accounts at all insured depository institutions. Due to the increased number of bank failures resulting from the credit crisis and severe recession, FDIC premiums have materially increased and are likely to increase further. This is a significant expense for us and is likely to continue to be.

*Dodd-Frank Wall Street Reform and Consumer Protection Act.* The Dodd-Frank Act was signed into law on July 21, 2010. Its wide ranging provisions affect all federal financial regulatory agencies and nearly every aspect of the American financial services industry. Among the provisions of the Dodd-Frank Act that directly impact the Company is the creation of an independent Consumer Financial Protection Bureau (CFPB), which has the ability to write rules for consumer protections governing all financial institutions. All consumer protection responsibility formerly handled by other banking regulators is consolidated in the CFPB. It will also oversee the enforcement of all federal laws intended to ensure fair access to credit. For smaller financial institutions such as the Company and the Bank, the CFPB will coordinate its examination activities through their primary regulators.

The Dodd-Frank Act contains provisions designed to reform mortgage lending, which includes the requirement of additional disclosures for consumer mortgages. In addition, the Federal Reserve has issued new rules that have the effect of limiting the fees charged to merchants for debit card transactions. The result of these rules will be to limit the amount of interchange fee income available explicitly to larger banks and indirectly to us. The Dodd-Frank Act also contains provisions that affect corporate governance and executive compensation.

Although the Dodd-Frank Act provisions themselves are extensive, the ultimate impact on the Company of this massive legislation is unknown. The Act provides that several federal agencies, including the Federal Reserve and the Securities and Exchange Commission, shall issue regulations implementing major portions of the legislation, and this process is ongoing.

*Future Regulatory Uncertainty.* Because federal and state regulation of financial institutions changes regularly and is the subject of constant legislative debate, New Peoples cannot forecast how regulation of financial institutions may change in the future and impact its operations. New Peoples fully expects that the financial institution industry will remain heavily regulated and that additional laws or regulations may be adopted further regulating specific banking practices.

## **Subsequent Events**

We have considered subsequent events through the date of the financial statements in this Form 10-K.

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### **Item 1A. Risk Factors**

Not applicable.

### **Item 1B. Unresolved Staff Comments**

Not applicable.

### **Item 2. Properties**

At December 31, 2012, the Company's net investment in premises and equipment in service was \$31.2 million. Our main office and operations center is located in Honaker, Virginia. This location contains a full service branch, and our administration and operations center.

The Bank owns all of its 23 full service branches, including its headquarter office. The location of these branches are described in Item 1.

The Bank owns a location in Dungannon, Virginia that half of the location was used for a branch location until its closure during 2010. The other half of the location is currently being leased. The Bank owns additional property in Princeton, West Virginia that is being developed for a future full service branch location, and currently serves as a loan administration office. The Princeton location is anticipated to operate as a full service branch in the distant future. During 2012, the Bank closed offices in Bristol, Pennington Gap, and Richlands, Virginia and Jonesborough, Tennessee. The Bristol office will be leased to the Bank's subsidiary NPB Insurance Services, Inc. in 2013. The Pennington Gap property was sold in January 2013. The other two offices are vacant and may be used for future banking offices again in the future when the economy recovers.

We believe that all of our properties are maintained in good operating condition and are suitable and adequate for our operational needs.

### **Item 3. Legal Proceedings**

In the course of operations, we may become a party to legal proceedings. We became aware of a lawsuit against the Bank in April 2010. This case involves a claim against the Bank by a joint venture between Bank customers, some of whom are former members of senior management, and three investors. The allegation is that the joint venture, VFI, should have priority over the Bank's deed of trust in order for VFI's unrecorded and unrecordable ground lease to be enforceable for its full ten year term. There are also additional claims for damages resulting from allegations that the Bank's representatives imputed liability to the Bank based upon breach of fiduciary duty, fraud, and collaboration. The parties agreed to litigate the ground lease issue first and are now in negotiations to resolve all pending issues due to the fact that the business associated with the building has ceased and the building is vacant. Attempts to mediate this matter have been unsuccessful and a pretrial hearing is set for April 2013. Management and Bank's counsel believe VFI's position is not supported by law or the facts presented.

### **Item 4. Mine Safety Disclosures**

Not applicable.

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities****(a) Market Information**

Registrar and Transfer Company is the stock transfer agent for New Peoples Bankshares, Inc. The common stock of New Peoples is quoted on the Over The Counter Bulletin Board (OTCBB) under the symbol NWPP. The volume of trading of shares of common stock is very limited. Trades in our common stock occur sporadically on a local basis and typically small volumes of stock is traded.

The high and low prices at which our common stock has traded known to us for each quarter in the past two years are set forth in the table below. These prices are obtained through inquiry of shareholders transferring stock and by our listing on the OTCBB. Other transactions may have occurred at prices about which we are not aware.

	2012		2011	
	High	Low	High	High
1 <sup>st</sup> quarter	\$ 3.00	\$ 1.50	\$ 10.00	\$ 4.00
2 <sup>nd</sup> quarter	1.50	1.05	5.00	5.00
3 <sup>rd</sup> quarter	5.00	1.07	3.00	3.00
4 <sup>th</sup> quarter	1.50	1.07	3.00	3.00

The most recent sales price of which management is aware was \$1.51 per share on March 8, 2013.

**(b) Holders**

On March 18, 2013, there were approximately 4,476 shareholders of record.

**(c) Dividends**

In order to preserve capital to support our growth in the past we have not paid cash dividends. The declaration of dividends in the future will depend on our earnings and capital requirements and compliance with regulatory mandates. We are subject to certain restrictions imposed by the reserve and capital requirements of federal and Virginia banking statutes and regulations. Moreover, the Written Agreement we have with the banking regulators prohibits the Company from paying any cash dividends and the Bank's ability to pay dividends to the Company. So long as these restrictions remain in place the Company will not pay any cash dividends. Thereafter, the Company may or may not pay cash dividends depending on various factors including capital needs, earnings, and other factors our Board of Directors deems relevant. As a result, we do not anticipate paying a dividend on our common stock in 2013. See Note 3, Note 16 and Note 22 of the Notes to the Consolidated Financial Statements for further discussion of dividend limitations and capital requirements.

**Item 6. Selected Financial Data**

Not applicable.

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**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**Caution About Forward Looking Statements**

We make forward looking statements in this annual report that are subject to risks and uncertainties. These forward looking statements include statements regarding our profitability, liquidity, allowance for loan losses, interest rate sensitivity, market risk, growth strategy, and financial and other goals. The words believes, expects, may, will, should, projects, contemplates, anticipates, forecasts, intends, or other similar terms are intended to identify forward looking statements. The forward-looking information is based on various factors and was derived using numerous assumptions. Important factors that may cause actual results to differ from projections include:

the success or failure of our efforts to implement our business plan;

achieving and maintaining compliance with the Written Agreement between us and the banking regulators;

any required increase in our regulatory capital ratios;

satisfying other regulatory requirements that may arise from examinations, changes in the law and other similar factors;

any substantial increase in nonperforming loans;

our ability to attract additional talent that we may need;

any required increase to our loan loss reserve;

the difficult market conditions in our industry;

the unprecedented levels of market volatility;

the effects of soundness of other financial institutions;

the uncertain outcome of recently enacted legislation to stabilize the U.S. financial system;

the potential impact on us of recently enacted legislation;

the lack of a market for our common stock;

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the ability to successfully manage our growth or implement our growth strategies if we are unable to identify attractive markets, locations or opportunities to expand in the future;

success in increasing capital to support our financial condition resulting from the recession;

in the near future, achieving the cost savings we project without customer rejection as we close unprofitable branches, and, in the longer term maintaining cost controls and asset qualities as we open or acquire new branches;

the successful management of interest rate risk;

changes in interest rates and interest rate policies;

reliance on our management team, including our ability to attract and retain key personnel;

changes in general economic and business conditions in our market area;

risks inherent in making loans such as repayment risks and fluctuating collateral values;

competition with other banks and financial institutions, and companies outside of the banking industry, including those companies that have substantially greater access to capital and other resources;

demand, development and acceptance of new products and services;

problems with technology utilized by us;

changing trends in customer profiles and behavior;

changes in governmental regulations, tax rates and similar matters; and

other risks which may be described in our future filings with the SEC.

Because of these uncertainties, our actual future results may be materially different from the results indicated by these forward looking statements. In addition, our past results of operations do not necessarily indicate our future results. We expressly disclaim any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

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### **General**

The following commentary discusses major components of our business and presents an overview of our consolidated financial position at December 31, 2012 and 2011 as well as results of operations for the years ended December 31, 2012 and 2011. This discussion should be reviewed in conjunction with the consolidated financial statements and accompanying notes and other statistical information presented elsewhere in this Form 10-K.

New Peoples generates a significant amount of its income from the net interest income earned by the Bank. Net interest income is the difference between interest income and interest expense. Interest income depends on the amount of interest-earning assets outstanding during the period and the interest rates earned thereon. The Bank's interest expense is a function of the average amount of deposits and borrowed money outstanding during the period and the interest rates paid thereon. The quality of the assets further influences the amount of interest income lost on nonaccrual loans and the amount of additions to the allowance for loan losses. The Bank also generates noninterest income from service charges on deposit accounts and commissions on insurance and investment products sold.

### **Written Agreement**

The Company and the Bank entered into a written agreement with the Federal Reserve Bank of Richmond and the Virginia Bureau of Financial Institutions. Under this Agreement, the Bank has agreed to develop and submit for approval within specified time periods written plans to: (a) strengthen board oversight of management and the Bank's operation; (b) if appropriate after review, to strengthen the Bank's management and board governance; (c) strengthen credit risk management policies; (d) enhance lending and credit administration; (e) enhance the Bank's management of commercial real estate concentrations; (f) conduct ongoing review and grading of the Bank's loan portfolio; (g) improve the Bank's position with respect to loans, relationships, or other assets in excess of \$1 million which are now or in the future become past due more than 90 days, which are on the Bank's problem loan list, or which are adversely classified in any report of examination of the Bank; (h) review and revise, as appropriate, current policy and maintain sound processes for maintaining an adequate allowance for loan and lease losses; (i) enhance management of the Bank's liquidity position and funds management practices; (j) revise its contingency funding plan; (k) revise its strategic plan; and (l) enhance the Bank's anti-money laundering and related activities.

In addition, the Bank has agreed that it will: (a) not extend, renew, or restructure any credit that has been criticized by the Reserve Bank or the Bureau absent prior board of directors approval in accordance with the restrictions in the Agreement; (b) eliminate all assets or portions of assets classified as loss and thereafter charge off all assets classified as loss in a federal or state report of examination, which has been done.

The Company and the Bank have agreed to submit capital plans to maintain sufficient capital at the Company, on a consolidated basis, and the Bank, on a stand-alone basis, and to refrain from declaring or paying dividends without prior regulatory approval. The Company has agreed that it will not take any other form of payment representing a reduction in the Bank's capital or make any distributions of interest, principal, or other sums on subordinated debentures or trust preferred securities without prior regulatory approval. The Company may not incur, increase or guarantee any debt without prior regulatory approval and has agreed not to purchase or redeem any shares of its stock without prior regulatory approval.

Under the terms of the Agreement, the Company and the Bank have appointed a committee to monitor compliance. The directors of the Company and the Bank have recognized and unanimously agree with the common goal of financial soundness represented by the Agreement and have confirmed the intent of the directors and executive management to diligently seek to comply with all requirements of the Written Agreement.

### **Written Agreement Progress Report**

At December 31, 2012, we believe we have not yet achieved full compliance with the Agreement but we have made progress in our compliance efforts under the Agreement. We are aggressively working to comply with the Agreement and have timely submitted each required plan by its respective deadline. We have hired an independent consultant to assist us in these efforts and the following actions have taken place:

1. With regard to corporate governance, we have established a weekly Director's Loan Committee to oversee all loan approvals and all loan renewals, extensions and approvals for loans risk rated Special Mention or worse, as well as, exposures exceeding the Chief Credit Officer's lending authority. This has enabled the Board to increase its oversight of the Bank's largest credit exposures and problem credits, and enhanced the monitoring and compliance with all loan policies and procedures. Secondly, we have enhanced our reporting of credit quality to the board. Furthermore, we have adopted formal charters for our Nominating, Compliance,



Compensation, and Loan Committees. A corporate governance policy was adopted by the Board of Directors on April 23, 2012.

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2. The requirement to assess the Board and management has been completed by an independent party. A report has been issued to the Board and recommendations are being followed. In September 2010, our President and CEO was added as a member of the Board and in November 2010, Eugene Hearl was added as a member of the Board. Mr. Hearl has over 40 years banking experience as President and CEO for two community banks and Regional President of a large regional financial institution.

In addition, training is a key initiative of both the Board of Directors and employees. Further training of the Board and employees has been implemented and will be ongoing.

A formal management succession plan has been developed and approved by the Board of Directors.

3. In the month of September 2010, a newly revised strategic plan and a capital plan were completed and submitted to our regulators. The 2011 Budget was submitted to our regulators in the fourth quarter of 2010. The 2012 Budget was submitted to our regulators also in the fourth quarter of 2011. The 2013 Budget was submitted to our regulators in January 2013.

A newly revised strategic plan for the years 2013 through 2015 was completed and submitted to the regulators in January 2013.

In September 2012, we converted notes payable to two of our directors totaling \$5.5 million plus accrued interest of \$272 thousand to common stock. As a result of the conversion, New Peoples returned to well capitalized status at September 30, 2012.

In accordance with our capital plan, we began a common stock offering in July 2012 to existing shareholders followed by an offering to the public during the third and fourth quarters of 2012. The offering was closed on December 20, 2012 and proceeds of \$12,061,257 were received on December 28, 2012. Upon receipt of the proceeds we injected \$7.0 million of capital into the Bank. The remaining net proceeds are held at the Company and will be used for payment of operating expenses and, when permitted by regulatory authorities, the payment of deferred trust preferred interest. The remaining additional cash may be used for future capital injections, if needed; thus, providing a source of strength at the holding company level for the Bank. In addition, the conversion of the director notes to common stock and the recent stock offering included common stock warrants that may be exercised in the next five years and potentially provide additional capital if, and when, they are exercised. A total of 2,370,900 common stock warrants were outstanding as of December 31, 2012 with an exercise price of \$1.75. Assuming all of these warrants are exercised before expiration, then an additional \$4.1 million in capital would be provided by their exercise.

4. Loan policies have been revised; an online approval and underwriting system for loans has been implemented; underwriting, monitoring and management of credits and collections have been enhanced; frequency of external loan reviews increased; and the focus on problem loans intensified at all levels in the organization. As a result, we are more timely in identifying problem loans. In the future, continuing these procedures should strengthen asset quality substantially. Further training of lending personnel is ongoing regarding proper risk grading of credits and identification of problem credits.
5. Enhanced loan concentration identification and new procedures for monitoring and managing concentrations have been implemented. Loan concentration targets have been established and efforts continue to reduce higher risk concentrations. In particular, construction and development loans and commercial real estate loans have been reduced and continue to decrease toward acceptable levels as determined by the new policies.
6. To strengthen management of credit quality and loan production, we added a new Chief Credit Officer, Stephen Trescot, in the first quarter of 2011 who brings vast credit administration experience to our management team. Sharon Borich, our former Chief Credit Officer, assumed the role of Senior Lending Officer with oversight of loan production and business development which is her area of expertise. In addition to new lending policies and procedures, the management of all real estate development projects and draws has been centralized. We have segregated the duties of lenders for greater specialization of commercial and retail lending responsibilities. As a result we have formed a Commercial Loan division that is supervised by the Senior Vice President and Senior Lending Officer. The retail loans are primarily the responsibility of branch personnel who report to branch managers and respective area managers.

In the fourth quarter of 2012, a Senior Vice President and Senior Credit Officer was added to the credit administration function providing additional management experience to the credit function. Karen Wimmer reports directly to Chief Credit Officer Trescot and oversees the credit administration area of the Bank



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The credit analysis function has been restructured and is a part of credit administration. The credit analysis function is led by a Vice President/Senior Analyst, who supervises three analysts, of which, two analysts are CPAs, the third has an MBA. The function reports directly to the Senior Vice President and Senior Credit Officer and is responsible for analyzing new and renewed loan relationships of \$250 thousand or more prior to approval and conducting annual financial reviews of loan relationships of \$500 thousand or more.

The appraisal review function, consisting of two Vice Presidents, one of which is an experienced licensed appraiser, and one administrative assistant, also reports directly to the Senior Credit Officer. The appraisal review function reviews the quality of appraisals on behalf of the Bank by reviewing the methods, assumptions, and value conclusions of internal and external appraisals. In addition, this data is used to determine whether an external appraiser should be utilized for future work.

7. We have retained an independent third party to perform loan reviews on a quarterly basis in 2010 and 2011 and engaged them to perform this function in June 2012 and December 2012. We have engaged them to perform this function in June 2013 and December 2013 as well. The third party loan review company has also conducted two loan portfolio stress tests for the Bank to obtain a better understanding of potential loan losses over a two year period.
8. To support the focus on problem credit management the Bank further developed, in March, 2011, a Special Assets department which reports to the Chief Credit Officer. Presently, the department has two workout specialists/Vice Presidents, one Vice President managing other real estate owned properties, an analyst, and two support personnel. Substantially all the relationships in the Bank with total commitments in excess of \$500,000 which are risk rated Special Mention or worse are assigned to this department. This department is organizationally structured to manage workout situations, collections, other real estate owned, nonperforming assets, watch list credits, and the Bank's legal department related to collection efforts. New reporting and monitoring is conducted monthly by this division. Material changes to Special Asset credits are reported to the Board at the time of occurrence and, quarterly, the Board receives written action plans and status updates of the Bank's twenty largest problem credits. A quarterly management watch list committee has been established to actively manage and monitor these credits.
9. A new allowance for loan loss model was implemented and reviewed independently during 2010. The Board has approved a new allowance for loan loss policy. We have shifted duties for maintaining the allowance for loan loss model and credit reporting to a more experienced employee. The allowance for loan loss and the methodology supporting the results are approved quarterly by the Audit Committee of the Board of Directors, and ratified by the Board.
10. We have significantly increased our asset based liquidity sources throughout 2010, 2011 and 2012 to meet financial obligations. A new liquidity risk management policy has been adopted and a revised contingency funding plan has been created. We have lost all of our federal funds lines of credit, but we have added an internet certificate of deposit funding source to increase contingent funding sources. We believe that we have adequate liquidity in normal and stressed situations. We are further developing an investment portfolio, as well. The investment portfolio has grown to \$49.6 million at December 31, 2012 from \$4.7 million at December 31, 2010.
11. In the fourth quarter of 2009, we ceased the declaration of dividends from the Bank to the Company. We also deferred interest payments on our trust preferred securities issuances.
12. Anti-money laundering and bank secrecy act programs and training have been enhanced.

## **Overview**

At December 31, 2012, total assets were \$719.0 million, total loans were \$522.4 million, and total deposits were \$652.9 million at December 31, 2012. The Company had a total net loss after tax of \$6.3 million or \$0.57 per basic share and per diluted share for the year ended December 31, 2012 as compared to a net loss of \$8.9 million, or \$0.89 per basic and per diluted share for the year ended December 31, 2011. The annualized return on average assets for the fiscal year 2012 was (0.86)% as compared to (1.07)% for the same period in 2011. The annualized return on average equity was (23.62)% for the fiscal year 2012 and (24.35)% for the same period in 2011. We did have a profitable fourth quarter in 2012

in which we made \$212 thousand, the first profitable quarter since March 31, 2011.

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During the year 2012, we strategically decreased total assets, total loans and higher cost deposits to improve our capital position. In December 2012, the Company successfully completed a public offering of its common stock, which resulted in net proceeds of \$11.4 million after \$624 thousand of expenses related to the offering. Upon completion of the offering and receipt of proceeds, \$7.0 million was injected in the Bank's capital. As a result of this shrinking and capital injection, the Bank improved its capital position and maintained a well-capitalized status throughout 2012. The following Bank ratios existed at December 31, 2012 as compared to December 31, 2011, respectively: Tier 1 leverage ratio of 7.08% versus 5.99%; Tier 1 risk based capital ratio of 11.60% versus 9.28%; and total risk based capital ratio of 12.88% versus 10.56%.

Total assets decreased \$61.4 million in 2012, or 7.86%, from \$780.4 million at December 31, 2011. Total loans decreased \$75.4 million in 2012, or 12.62%, from \$597.8 million at December 31, 2011. This is the result of charge offs of \$6.8 million during 2012, resolution of problem loans, slow economic recovery in our market area, decreased loan demand, tighter underwriting guidelines, and the intentional shrinking of the loan portfolio to increase regulatory capital ratios. Total deposits decreased \$55.4 million, or 7.83%, from \$708.3 million at December 31, 2011. The largest decrease in deposits has taken place in time deposits which have decreased from \$445.7 million at December 31, 2011 to \$372.5 million at December 31, 2011. This \$73.2 million decrease in time deposits, or 16.42%, is the result of decreased interest rates offered in this very low interest rate environment.

For the year ending December 31, 2012, we experienced a net loss of \$6.3 million as compared to a \$8.9 million loss for the same period in 2011. In the year 2012, the net loss was primarily related to four areas: lower net interest income, provisions for loan losses, other real estate related expenses and a valuation allowance on our deferred tax asset. We maintained a strong net interest margin of 4.13% in 2012 as compared to 4.29% in 2011. However, the decreased volume of earning assets in 2012 and high levels of nonperforming assets decreased net interest income to \$27.3 million in 2012 from \$32.2 million in 2011. In 2012, we made \$4.8 million in provisions for loan losses. Although lower than 2011's total of \$8.0 million, the level remains high. Expenses related to other real estate owned properties were \$4.5 million in 2012. This category of expenses was less than the \$5.6 million in 2011, but it remained a negative impact on earnings. We also incurred a valuation allowance on our deferred tax asset totaling \$4.1 million during which has a direct impact on the net loss in 2012. We may be able to reverse the valuation allowance in the future as earnings improve resulting in taxable income to offset net loss tax carryforwards.

In May 2012, we closed four offices and merged them into existing nearby offices as a cost savings measure. This was the result of thorough branch analysis and performance evaluation. We continue to evaluate our branch network and operations to improve earnings.

The ratio of nonperforming assets to total assets lowered to 6.67% at December 31, 2012 as compared to 7.55% at December 31, 2011. Nonperforming assets, which include nonaccrual loans, other real estate owned and past due loans greater than 90 days still accruing interest, decreased during 2012. At December 31, 2012, nonperforming assets totaled \$48.0 million as compared to \$58.9 million at December 31, 2011 a reduction of \$10.9 million, or 18.60%. The majority of these assets are commercial real estate and farmland real estate secured loans and other real estate owned properties. We still have some real estate development projects both inside and outside of our market area, but at reduced levels than in the past. These loans outside our market area are primarily in the coastal Carolinas; which amount to only \$1.8 million at December 31, 2012 as compared to \$2.5 million at December 31, 2011. In addition, there are also some similar projects located in Northeastern Tennessee and one in eastern West Virginia. We are undertaking extensive efforts to work out these credits and liquidate foreclosed properties. This will take some time, but overall we believe we are making progress.

During 2012, we have continued our progress in identifying the risks in our loan portfolio. In addition, we have continued to improve our lending policies and train our lending staff on these policies and procedures. Each of these steps are critical to minimize future losses and to strengthen asset quality of the Bank. Our allowance for loan loss at December 31, 2012 is \$16.8 million, or 3.22% as compared to \$18.4 million, or 3.07% at December 31, 2011. The provision for loan losses decreased to \$4.8 million in 2012 as compared to \$8.0 million in 2011. We continue to maintain a higher level in the allowance for loan loss in light of the current economic circumstances, including the anemic recovery and believe that this level is adequate. Future provisions may be deemed necessary, however. Net charge-offs year-to-date for 2012 as a percentage of total average loans improved to 1.14% as compared to 2.24% in 2011. Impaired loans decreased \$26.6 million, or 28.98%, in 2012 to \$65.2 million with an estimated allowance of \$5.9 million for potential losses at December 31, 2012 as compared to \$91.8 million in impaired loans with an estimated allowance of \$6.0 million at the end of 2011.

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### **Critical Accounting Policies**

Certain critical accounting policies affect the more significant judgments and estimates used in the preparation of our financial statements. Our most critical accounting policies relate to our provision for loan losses and the calculation of our deferred tax asset and valuation allowance.

The provision for loan losses reflects the estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our borrowers were to further deteriorate, resulting in an impairment of their ability to make payments, our estimates would be updated, and additional provisions could be required. For further discussion of the estimates used in determining the allowance for loan losses, we refer you to the section on **Provision for Loan Losses** in this discussion.

Our deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. If all or a portion of the net deferred tax asset is determined to be unlikely to be realized, a valuation allowance is established to reduce the net deferred tax asset to the amount that is more likely than not to be realized. For further discussion of the deferred tax asset and valuation allowance, we refer you to the section on **Deferred Tax Asset and Income Taxes** in this discussion.

For further discussion of our other critical accounting policies, see Note 2, **Summary of Significant Accounting Policies**, to our Consolidated Financial Statements, found in Item 8 to this annual report on Form 10-K.

### **Net Interest Income and Net Interest Margin**

The Company's primary source of income, net interest income, decreased \$4.9 million, or 15.20% from 2011 to 2012. The decrease in net interest income is due primarily to a reduction in loans during 2012 and the level of nonearning assets, i.e. nonaccrual loans and other real estate owned properties. Loan interest income decreased \$8.6 million, or 20.85%, from \$41.2 million in 2011 to \$32.6 million in 2012. Interest expense decreased \$3.1 million, or 32.75%, from \$9.6 million for the year ending 2011 to \$6.5 million in 2012 as a result of deposits re-pricing at lower interest rates at maturity, and a shift in the deposit mix whereby our higher cost time deposits were replaced with lower cost deposit products. The net interest margin for the year ending December 31, 2012 was 4.13% as compared to 4.29% for the same period in 2011. We are trying to preserve the net interest margin, but we may experience some further decrease in the net interest margin as new and renewed loans are sometimes priced at lower market interest rates. Because of the tightening of our underwriting, loan pricing may be lower than historically; however, typically more conservative underwriting reduces the likelihood of future loan losses. Loan losses negatively impact earnings through various related expenses, for example, loan loss provisions, collection expenses, etc.

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The following table shows the rates paid on earning assets and deposit liabilities for the periods indicated.

<b>Net Interest Margin Analysis</b>									
<b>Average Balances, Income and Expense, and Yields and Rates</b>									
(Dollars in thousands)									
	For the Year Ended December 31, 2012			For the Year Ended December 31, 2011			For the Year Ended December 31, 2010		
	Average Balance	Income/ Expense	Yields/ Rates	Average Balance	Income/ Expense	Yields/ Rates	Average Balance	Income/ Expense	Yields/ Rates
<b>ASSETS</b>									
Loans (1), (2), (3)	\$ 556,504	\$ 32,592	5.86%	\$ 659,298	\$ 41,176	6.25%	\$ 742,026	\$ 47,775	6.44%
Federal funds sold	1,216	3	0.25%	6,202	9	0.15%	25,763	44	0.17%
Interest bearing deposits	58,677	173	0.29%	74,000	184	0.25%	8,349	12	0.14%
Other investments (3)	44,307	965	2.18%	10,952	400	3.65%	7,590	197	2.61%
<b>Total Earning Assets</b>	<b>660,704</b>	<b>33,733</b>	<b>5.11%</b>	<b>750,452</b>	<b>41,769</b>	<b>5.57%</b>	<b>783,728</b>	<b>48,028</b>	<b>6.13%</b>
Less: Allowance for loans losses	(18,475)			(20,805)			(18,607)		
Non-earning assets	92,494			101,972			97,997		
<b>Total Assets</b>	<b>\$ 734,723</b>			<b>\$ 831,619</b>			<b>\$ 863,118</b>		
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>									
<b>Deposits</b>									
Demand Interest bearing	\$ 61,842	\$ 110	0.18%	\$ 57,675	\$ 155	0.27%	\$ 56,791	\$ 250	0.44%
Savings	96,764	242	0.25%	103,346	460	0.45%	92,622	779	0.84%
Time deposits	406,669	5,018	1.23%	485,072	7,717	1.59%	523,990	11,112	2.12%
Other Borrowings	15,487	600	3.87%	24,151	838	3.47%	29,721	1,303	4.39%
Trust Preferred Securities	16,496	490	2.97%	16,496	436	2.64%	16,496	454	2.75%
<b>Total interest bearing liabilities</b>	<b>597,258</b>	<b>6,460</b>	<b>1.08%</b>	<b>686,740</b>	<b>9,606</b>	<b>1.40%</b>	<b>719,620</b>	<b>13,898</b>	<b>1.93%</b>
Non-interest bearing deposits	106,780			102,957			92,943		
Other liabilities	3,913			5,338			4,307		
<b>Total Liabilities</b>	<b>707,951</b>			<b>795,035</b>			<b>816,870</b>		
Stockholders Equity	26,772			36,584			46,248		
<b>Total Liabilities and Stockholders Equity</b>	<b>\$ 734,723</b>			<b>\$ 831,619</b>			<b>\$ 863,118</b>		
<b>Net Interest Income</b>		<b>\$ 27,273</b>			<b>\$ 32,163</b>			<b>\$ 34,130</b>	
<b>Net Interest Margin</b>			<b>4.13%</b>			<b>4.29%</b>			<b>4.35%</b>
<b>Net Interest Spread</b>			<b>4.03%</b>			<b>4.17%</b>			<b>4.20%</b>

(1) Non-accrual loans have been included in the average balance of loans outstanding.

(2) Loan fees have been included in interest income on loans.



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(3) Tax exempt income is not significant and has been treated as fully taxable.

Net interest income is affected by changes in both average interest rates and average volumes of interest-earning assets and interest-bearing liabilities. The following table sets forth the amounts of the total changes in interest income and expense which can be attributed to rate (change in rate multiplied by old volume) and volume (change in volume multiplied by old rate) for the periods indicated.

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	<b>Volume and Rate Analysis</b>					
	(Dollars in thousands)					
	2012 Compared to 2011 Increase (Decrease)			2011 Compared to 2010 Increase (Decrease)		
	Volume Effect	Rate Effect	Change in Interest Income/ Expense	Volume Effect	Rate Effect	Change in Interest Income/ Expense
<b>Interest Income:</b>						
Loans	\$ (6,420)	\$ (2,164)	\$ (8,584)	\$ (5,326)	\$ (1,273)	\$ (6,599)
Federal funds sold	(7)	1	(6)	(33)	(2)	(35)
Interest bearing deposits	(38)	27	(11)	94	78	172
Other investments	1,218	(653)	565	87	116	203
<b>Total Earning Assets</b>	<b>(5,247)</b>	<b>(2,789)</b>	<b>(8,036)</b>	<b>(5,178)</b>	<b>(1,081)</b>	<b>(6,259)</b>
<b>Interest Bearing Liabilities:</b>						
Demand	11	(56)	(45)	4	(99)	(95)
Savings	(29)	(189)	(218)	90	(409)	(319)
All other time deposits	(1,247)	(1,452)	(2,699)	(825)	(2,570)	(3,395)
Other borrowings	(301)	63	(238)	(244)	(221)	(465)
Trust Preferred Securities		54	54		(18)	(18)
<b>Total Interest Bearing Liabilities</b>	<b>(1,566)</b>	<b>(1,580)</b>	<b>(3,146)</b>	<b>(975)</b>	<b>(3,317)</b>	<b>(4,292)</b>
<b>Change in Net Interest Income</b>	<b>\$ (3,681)</b>	<b>\$ (1,209)</b>	<b>\$ (4,890)</b>	<b>\$ (4,203)</b>	<b>\$ 2,236</b>	<b>\$ (1,967)</b>

**Loans**

Our primary source of income comes from interest earned on loans. Loan production slowed in 2012 as evidenced by total loans decreasing \$75.4 million, or 12.62%, including net charge offs of \$6.4 million. This is due to the resolution of problem loans, decreased loan demand, tighter underwriting guidelines, and the intentional shrinking of the loan portfolio to increase regulatory capital ratios. We continue to serve our customers, and although the total loan portfolio has been reduced, we continue to renew existing credits and make new loans to qualified borrowers as well. We anticipate some further decreases in the loan portfolio in the near future primarily as we reduce our exposure to certain credit and market risks and decrease nonperforming loans. Lending personnel are focused on developing new and existing lending relationships which should slow the pace of the reduction in total loans subject to the impact of the underperforming economy and heightened competition in the banking industry. Total loans decreased \$75.4 million in 2012 from 2011. A schedule of loans by type is set forth immediately below. Approximately 81.75% of the loan portfolio is secured by real estate at the end of 2012.

Loans receivable outstanding are summarized as follows:

(Dollars in thousands)	<b>Loan Portfolio</b>				
	December 31,				
	2012	2011	2010	2009	2008
Commercial, financial and agricultural	\$ 65,888	\$ 85,798	\$ 109,418	\$ 118,844	\$ 110,060
Real estate construction	24,327	32,389	52,307	71,854	64,595
Real estate mortgage	402,703	441,107	489,314	504,071	483,471
Installment loans to individuals	29,445	38,522	56,755	68,801	63,048
<b>Total</b>	<b>\$ 522,363</b>	<b>\$ 597,816</b>	<b>\$ 707,794</b>	<b>\$ 763,570</b>	<b>\$ 721,174</b>



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Our loan maturities as of December 31, 2012 are shown in the following table:

(Dollars in thousands)	Maturities of Loans			Total
	Less than One Year	One to Five Years	After Five Years	
Commercial, financial and agricultural	\$ 26,534	\$ 34,243	\$ 5,111	\$ 65,888
Real estate construction	6,093	11,963	6,271	24,327
Real estate mortgage	84,669	210,561	107,473	402,703
Installment loans to individuals	7,067	19,646	2,732	29,445
<b>Total</b>	<b>\$ 124,363</b>	<b>\$ 276,413</b>	<b>\$ 121,587</b>	<b>\$ 522,363</b>
Loans with fixed rates	\$ 44,221	\$ 104,276	\$ 120,232	\$ 268,729
Loans with variable rates	80,142	172,137	1,355	253,634
<b>Total</b>	<b>\$ 124,363</b>	<b>\$ 276,413</b>	<b>\$ 121,587</b>	<b>\$ 522,363</b>

The above table reflects the earlier of the maturity or re-pricing dates for loans at December 31, 2012. In preparing this table, no assumptions are made with respect to loan prepayments. Loan principal payments are included in the earliest period in which the loan matures or can be re-priced. Principal payments on installment loans scheduled prior to maturity are included in the period of maturity or re-pricing.

**Provision for Loan Losses**

The calculation of the allowance for loan losses is considered a critical accounting policy. The adequacy of the allowance for loan losses is based upon management's judgment and analysis. The following factors are included in our evaluation of determining the adequacy of the allowance: risk characteristics of the loan portfolio, current and historical loss experience, concentrations and internal and external factors such as general economic conditions.

The allowance for loan losses decreased to \$16.8 million at December 31, 2012 as compared to \$18.4 million at December 31, 2011. Even so, the allowance for loan losses at the end of 2012 was approximately 3.22% of total loans as compared to 3.07% at the end of 2011. Net loans charged off decreased in 2012 as they were \$6.4 million, or 1.14% of average loans, compared to \$14.7 million, or 2.24% of average loans, in 2011. The provision for loan losses also decreased to \$4.8 million for 2012 as compared with \$8.0 million for 2011.

We have experienced a decrease in loan delinquencies and nonaccrual loans in 2012. However, loans delinquent greater than 90 days still accruing interest and loans in non-accrual status present higher risks of default and loan losses. At December 31, 2012, there were 112 loans in non-accrual status totaling \$33.5 million, or 6.42% of total loans down from the levels at December 31, 2011, in which there were 170 loans in non-accrual status totaling \$42.3 million, or 7.08% of total loans. The amounts of interest that would have been recognized on these loans were \$1.4 million and \$1.3 million in the years 2012 and 2011, respectively. There were 15 loans past due 90 days or greater and still accruing interest totaling \$511 thousand, or 0.10% of total loans at December 31, 2012 down from 47 loans past due 90 days or greater and still accruing interest totaling \$1.5 million at year end 2011. It is our policy to stop accruing interest on a loan, and to classify that loan as non-accrual, under the following circumstances: (a) whenever we are advised by the borrower that scheduled payment or interest payments cannot be met, (b) when our best judgment indicates that payment in full of principal and interest can no longer be expected, or (c) when any such loan or obligation becomes delinquent for 90 days unless it is both well secured and in the process of collection. There were \$20.0 million in loans classified as troubled debt restructurings as of December 31, 2012, also an improvement, as compared to \$29.1 million in loans classified as troubled debt restructurings as of December 31, 2011. Of the loans classified as troubled debt restructurings at December 31, 2012, \$5.4 million were in non-accrual status, compared to \$8.2 million at December 31, 2011. We do not have any commitments to lend additional funds to non-performing debtors.

Certain risks exist in the Bank's loan portfolio. A majority of our loans are collateralized by real estate located in our market area. It is our policy to sufficiently collateralize loans to help minimize loss exposures in case of default. With the exception of real estate development type properties which have experienced more deterioration in market values, the local residential and commercial real estate market values have shown some deterioration but remain relatively stable. It is uncertain as to when or if local real estate values will be more significantly impacted. We do not believe that there will be a severely negative effect in our market area, but because of the uncertainty we deem it prudent to assign more of the allowance to these types of loans. Our market area is somewhat diverse, but certain areas are more reliant upon agriculture, coal

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mining and natural gas. As a result, increased risk of loan impairments is possible as the coal mining and natural gas industry have been negatively affected in the past year due to layoffs and environmental legislation. We do not foresee a major impact upon the Bank unless a severe downturn occurs which we believe is not highly likely. We are monitoring these industries. We consider these factors to be the primary higher risk characteristics of the loan portfolio.

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Commercial loans are initially risk rated by the originating loan officer. If deteriorations in the financial condition of the borrower and the capacity to repay the debt occur, along with other factors, the loan may be downgraded. This is to be determined by the loan officer. Guidance for the evaluation is established by the regulatory authorities who periodically review the Bank's loan portfolio for compliance. Classifications used by the Bank are exceptional, very good, standard, acceptable, transitory risk, other assets especially mentioned, substandard, doubtful and loss. For the year 2012, we engaged a third party loan review firm to conduct semiannual loan reviews and have engaged them to perform this function in 2013 on a semiannual basis. Upon their review, loans risk ratings may change from the rating assigned by the respective lender. We have experienced fewer rating changes in more recent reviews indicating better risk identification for the loan portfolio in light of the experience from the severe recession.

In regards to its consumer loans and consumer real estate loan portfolio, the Company uses a conservative approach for its risk grading and timing of charge offs on these loans. This approach is based on the guidance found in the Uniform Retail Credit Classification and Account Management Policy and as a result affects our estimate of the allowance for loan losses. Under this approach when a consumer loan or consumer real estate loan is originated, it must possess qualities of a credit risk grade of Pass for approval and will remain with the initial risk rating through maturity unless there is a deterioration in the credit quality of the loan. Subsequently, if the loan becomes contractually 90 days past due or the borrower files for bankruptcy protection, it is downgraded to Substandard. At 90 days past due, or earlier if the customer has filed bankruptcy, the collateral value less estimated liquidation costs is compared to the loan balance to calculate any potential deficiency. If there is sufficient collateral, no charge-off is necessary. If there is a deficiency, then within 30 days of the loan becoming 90 days past due, or within 60 days of bankruptcy notice, the deficiency is charged-off against the allowance for loan loss. If the loan is unsecured, upon being deemed Substandard, the entire loan amount is charged off. Collection efforts continue by means of repossessions or foreclosures, and upon bank ownership, liquidation ensues.

All loans classified as special mention, substandard, doubtful and loss are individually reviewed for impairment. In determining impairment, collateral for loans classified as substandard, doubtful and loss is reviewed to determine if the collateral is sufficient for each of these credits, generally through the review of the appraisal. If the appraisal is current, less than twelve months old, and has been reviewed, then if no negative information regarding the appraised value is obtained, the value is accepted, and impairment, if required is made. If the appraisal is not current, we perform a useful life review of the appraisal to determine if it is reasonable. If this review determines that the appraisal is not reasonable, then a new appraisal is ordered, in most cases. In determining the component of our allowance in accordance with the Contingencies topic of the Accounting Standards Codification (ASC 450), we do not directly consider the potential for outdated appraisals since that portion of our allowance is based on the analysis of the performance of loans with similar characteristics, external and internal risk factors. We consider the overall quality of our underwriting process in our internal risk factors, but the need to update appraisals is associated with loans identified as impaired under the Receivables topic of the Accounting Standards Codification (ASC 310). If an appraisal is older than one year, a new external certified appraisal may be obtained and used to determine impairment. If an exposure exists, a specific allowance is directly made for the amount of the potential loss in addition to estimated liquidation and disposal costs. The evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. Impaired loans decreased to \$65.2 million with \$28.1 million requiring a valuation allowance of \$5.9 million at December 31, 2012 as compared to \$91.8 million with \$30.0 million requiring a valuation allowance of \$6.0 million at December 31, 2011. Of the \$65.2 million recorded as impaired loans, \$30.6 million were nonperforming loans, which includes nonaccrual loans and past due 90 days or more. Management is aggressively working to reduce the impaired credits at minimal loss.

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Following is a summary of non-accrual and past due loans greater than 90 days still accruing interest:

<b>Non-Accrual and Past Due Loans</b>					
(Dollars in thousands)					
	2012	2011	December 31, 2010	2009	2008
<b>Non-accruing loans</b>					
Commercial, financial and agricultural	\$ 10,962	\$ 10,633	\$ 5,970	\$ 1,027	\$ 100
Real estate construction	2,412	5,583	15,460	13,727	2,875
Real estate mortgage	20,153	26,099	22,986	9,670	3,269
Installment loans to individuals	9	1	1,365	289	170
<b>Total Non-accruing loans</b>	<b>33,536</b>	<b>42,316</b>	<b>45,781</b>	<b>24,713</b>	<b>6,414</b>
<b>Loans past due 90 days or more and still accruing</b>	<b>551</b>	<b>1,504</b>	<b>1,693</b>	<b>3,875</b>	<b>33</b>
<b>Total</b>	<b>\$ 34,087</b>	<b>\$ 43,820</b>	<b>\$ 47,474</b>	<b>\$ 28,588</b>	<b>\$ 6,447</b>
<b>Percent of total loans</b>	<b>6.53%</b>	<b>7.33%</b>	<b>6.71%</b>	<b>3.74%</b>	<b>0.89%</b>

The above table includes \$5.4 million and \$8.2 million in nonaccrual loans as of December 31, 2012 and 2011, respectively, that have been classified as troubled debt restructurings. No troubled debt restructurings were past due 90 days or more and still accruing as of December 31, 2012 and 2011. There were \$20.0 million in loans classified as troubled debt restructurings as of December 31, 2012, as compared to \$29.1 million in loans classified as troubled debt restructurings as of December 31, 2011.

In addition to impaired loans, the remaining loan portfolio is evaluated based on past due history, economic conditions, and internal processes. During 2011, we changed methodology of determining historical loss factors by applying our historical loss rates instead of a weighted approach that was based on the greater of Virginia peers or our own historical loss rates. Previously, we did not have sufficient historical loss rates for certain types of loans, but a loss trend has now developed and provides better support than previous data. Economic data currently used includes national and local regional unemployment information, local housing price changes, gross domestic product growth, and interest rates are external factors. Lastly, we also evaluate our internal processes of underwriting and consider the inherent risks present in the portfolio due to past and present lending practices. In the past, these factors were not directly allocated to a particular loan category and were considered unallocated in the breakdown data in the table below. During 2011, however, we further analyzed our loan portfolio and the various unallocated internal and external factors. From our analysis, we determined that certain unallocated factors were relevant to certain sectors of the loan portfolio and some to each sector. These factors were allocated accordingly. As economic conditions, performance of our loans and internal processes change, it is possible that future increases may be needed to the allowance for loan losses. The following table provides a summary of the activity in the allowance for loan losses.

<b>Analysis of the Allowance for Loan Losses</b>					
(Dollars in thousands)					
Activity	For the Years Ended December 31,				
	2012	2011	2010	2009	2008
Beginning Balance	\$ 18,380	\$ 25,014	\$ 18,588	\$ 6,904	\$ 6,620
Provision charged to expense	4,800	7,959	22,328	12,841	1,500
Advances made on loans with off balance sheet provision		153			
<b>Loan Losses:</b>					
Commercial, financial and agricultural	(1,523)	(4,022)	(1,911)	(129)	(591)
Real estate construction	(357)	(7,245)	(10,002)	(446)	(44)
Real estate mortgage	(4,535)	(5,446)	(3,867)	(367)	(256)
Installment loans to individuals	(336)	(694)	(728)	(334)	(420)

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Total loan losses	(6,751)	(17,407)	(16,508)	(1,276)	(1,311)
Recoveries:					
Commercial, financial and agricultural	97	224	530	37	18
Real estate construction	73	1,296		8	
Real estate mortgage	148	1,018	6	21	17
Installment loans to individuals	63	123	70	53	60
Total recoveries	381	2,661	606	119	95
Net charge offs	(6,370)	(14,746)	(15,902)	(1,157)	(1,216)
Balance at End of Period	\$ 16,810	\$ 18,380	\$ 25,014	\$ 18,588	\$ 6,904
Net charge offs as a % of average loans	1.14%	2.24%	2.14%	0.15%	0.17%

We have allocated the allowance according to the amount deemed to be reasonably necessary to provide for the possibility of losses being incurred within each of the categories of loans. The allocation of the allowance as shown



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in the following table should not be interpreted as an indication that loan losses in future years will occur in the same proportions or that the allocation indicates future loan loss trends. Furthermore, the portion allocated to each loan category is not the total amount available for future losses that might occur within such categories since the total allowance is a general allowance applicable to the entire portfolio.

The allocation of the allowance for loan losses is based on our judgment of the relative risk associated with each type of loan. We have allocated 62% of the allowance to real estate loans, which constituted 77.09% of our loan portfolio at December 31, 2012. Mortgage loans are secured by real estate whose value tends to be easily ascertainable. These loans are made consistent with appraisal policies and real estate lending policies, which detail maximum loan-to-value ratios and maturities.

We have allocated 13% of the allowance to real estate construction loans, which constituted 4.66% of our loan portfolio at December 31, 2012. Construction loans are secured by real estate with values that are dependent upon market and economic conditions. Values may not always be easily ascertainable as evidenced by the current market conditions. These loans are made consistent with appraisal policies and real estate lending policies which detail maximum loan-to-value ratios and maturities. Our allocation decreased as a percentage of the allowance for loan losses due to the \$8.1 million decrease in construction real estate loans during 2012.

We have allocated 20% of the allowance to commercial loans, which constituted 12.61% of our loan portfolio at December 31, 2012. This allocation remained comparable to the 18% in 2011 despite the fact commercial loans decreased \$19.9 million from 2011 to 2012 due to the \$1.5 million in charge offs during 2012 that impacts our historical loss rate.

We have allocated 2% of the allowance to consumer installment loans, which constituted 5.64% of our loan portfolio at December 31, 2012. The reason for the decrease in the allocation was the result of the \$9.1 million decrease in these loans during 2012.

The following table shows the balance and percentage of our allowance for loan losses (or ALLL ) allocated to each major category of loans.

**Allocation of the Allowance for Loan Losses**  
**December 31, 2008 through December 31, 2012**  
(Dollars in thousands)

	December 31, 2012			December 31, 2011			December 31, 2010		
	Amount	% of ALLL	% of Loans	Amount	% of ALLL	% of Loans	Amount	% of ALLL	% of Loans
Commercial	\$ 3,383	20%	12.61%	\$ 3,322	18%	14.35%	\$ 5,323	21%	15.48%
R/E const.	2,166	13%	4.66%	3,848	21%	5.42%	4,913	20%	7.39%
R/E mortg.	10,322	62%	77.09%	9,578	52%	73.79%	6,882	27%	69.13%
Installment	388	2%	5.64%	781	4%	6.44%	1,733	7%	8.00%
Unallocated	551	3%		851	5%		6,163	25%	
Total	\$ 16,810	100%	100.00%	\$ 18,380	100%	100.00%	\$ 25,014	100%	100.00%

	December 31, 2009			December 31, 2008		
	Amount	% of ALLL	% of Loans	Amount	% of ALLL	% of Loans
Commercial	\$ 1,710	9%	15.56%	\$ 3,866	56%	15.26%
R/E const.	8,036	43%	9.41%	621	9%	8.96%
R/E mortg.	3,525	19%	66.02%	1,036	15%	67.04%
Installment	1,501	8%	9.01%	1,381	20%	8.74%
Unallocated	3,816	21%				

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Total	\$ 18,588	100%	100.00%	6,904	100%	100.00%
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**Table of Contents****Other Real Estate Owned**

Other real estate owned decreased \$1.2 million, or 8.10%, to \$13.9 million at December 31, 2012 from \$15.1 million at December 31, 2011. We anticipate total other real estate owned to increase in the near future as we foreclose on real estate collateralized loans. All properties are being marketed for sale by commercial and residential realtors under the direction of our Special Assets division. During 2012, we were able to sell \$8.1 million of our properties as compared to sales of \$5.9 million in 2011. As a result we incurred losses on the sales of these properties in the amounts of \$480 thousand and \$218 thousand for the years 2012 and 2011, respectively. Future sales of these properties are contingent upon an economic recovery; consequently, it is difficult to estimate the duration of our ownership of these assets. We have designated employees to monitor other real estate owned properties to ensure proper fair market values of these assets and to ensure that maintenance and improvements are made to make these properties more marketable. During 2012 we had to record writedowns on other real estate owned properties in the amount of \$2.6 million compared to \$4.0 million in 2011. This was due to the receipt of updated valuations on the other real estate owned properties, which showed a lower fair value than our carrying amount of the properties, and accordingly we recorded a writedown on the properties.

**Investment Securities**

Total investment securities increased to \$49.6 million at December 31, 2012 from \$32.4 million at December 31, 2011 as we have intentionally increased the investment portfolio of the Bank. All securities are classified as available-for-sale for liquidity purposes. Investment securities with a carrying value of \$18.4 million and \$15.7 million at December 31, 2012 and 2011, were pledged to secure public deposits, overnight payment processing and for other purposes required by law.

As we curtail loans, we continue to build an investment portfolio. We anticipate slightly increasing the size of the portfolio during 2013. The portfolio will be comprised of short to mid-term investments.

The carrying values of investment securities and the different types of investments are shown in the following table:

<b>Investment Securities Portfolio</b>				
(Dollars in thousands)				
December 31,	2012		2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for Sale				
U.S. Government Agencies	\$ 23,177	\$ 23,637	\$ 21,405	\$ 21,633
Taxable municipals			1,465	1,552
Tax-exempt municipals			1,043	1,054
Mortgage backed securities	25,822	25,978	8,144	8,195
<b>Total Securities AFS</b>	<b>\$ 48,999</b>	<b>\$ 49,615</b>	<b>\$ 32,057</b>	<b>\$ 32,434</b>

The amortized cost, fair value and weighted average yield of investment securities at December 31, 2012 are shown by contractual maturity and do not reflect principal paydowns for amortizing securities, in the following schedule. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

<b>Maturities of Securities</b>			
(Dollars are in thousands)			
(Dollars are in thousands)	Amortized Cost	Fair Value	Weighted Average Yield
Securities Available for Sale			
Due in one year or less	\$ 1,479	\$ 1,489	1.00%
Due after one year through five years	12,240	12,357	1.46%
Due after five years through fifteen years	35,280	35,769	1.93%

Total	\$ 48,999	\$ 49,615	1.78%
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**Deposits**

Total deposits were \$652.9 million at December 31, 2012, a decrease of \$55.4 million, or 7.83%, from \$708.3 million at December 31, 2011. This decrease is attributed to our plan to decrease higher cost deposits in order to improve earnings and increase capital ratios. Most of the decrease has been in time deposits which are our highest cost deposit funding source. During 2012 we experienced a decrease in time deposits of \$73.2 million. This is the result of decreased interest rates offered in this very low interest rate environment. During 2012, interest rate sensitive deposits have withdrawn to seek other investment opportunities.

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Demand deposits remained substantially at the same level as they slightly decreased 0.52%, or \$1.0 million, from \$168.1 million at December 31, 2011 to \$167.1 million at December 31, 2012. We continue to maintain demand deposits through attractive consumer and commercial deposit products and strong ties with our customer base and communities. Savings deposits increased \$18.7 million, or 19.78%, to \$113.3 million at December 31, 2012 as compared to \$94.6 million at December 31, 2011.

We expect to continue to lose higher cost and rate sensitive deposits in the near future, but at a decreased pace than in the past. However, we monitor deposits to ensure that we maintain adequate liquidity levels. We believe despite the deposit decrease, we have adequate liquidity.

Time deposits of \$100,000 or more equaled approximately 21.37% of deposits at the end of 2012 and 23.61% of deposits at the end of 2011.

We have brokered deposits totaling \$2.7 million with a term of 10 years. These deposits were used to fund a particular 10 year balloon mortgage product. Internet accounts are limited to customers located in the surrounding geographical area. The average balance of and the average rate paid on deposits is shown in the net interest margin analysis above. Total CDARs time deposits decreased to \$7.2 million in 2012 as compared to \$8.2 million in 2011 primarily due to lower interest rates offered by us.

Maturities of time deposits of \$100,000 or more outstanding are summarized as follows:

<b>Maturities of Time Deposits of \$100 Thousand and More</b>	
(Dollars in thousands)	
December 31, 2012	
Three months or less	\$ 29,337
Over three months through six months	21,293
Over six months through twelve months	29,765
Over one year	59,144
<b>Total</b>	<b>\$ 139,539</b>

**Noninterest Income**

Noninterest income was \$5.6 million in 2012 which was comparable to the \$5.5 million in 2011. During 2012 we had \$537 thousand in realized gains on the sale of investment securities. Noninterest income as a percentage of average assets increased as a percentage. The ratio was 0.76% in 2012 as compared to 0.66% in 2011. We anticipate this percentage to remain flat during 2013 due to regulatory actions regarding these types of income sources; however, we continue to seek opportunities to improve noninterest income. As a part of these efforts, in June 2012 we changed the name of NPB Financial Services, Inc. to NPB Insurance Services, Inc., which will operate solely as a full-service insurance agency, dealing in personal and group life, health, and disability products in 2013.

**Noninterest Expense**

Noninterest expenses decreased \$7.4 million, or 18.86%, to \$32.0 million in 2012 from \$39.4 million in 2011. The following are explanations of the decrease in non-interest expenses during 2012.

During 2011 we realized, a one time non-recurring expense of \$4.1 million related to the impairment of goodwill which completely wrote-off this asset. This was a result of management's reassessment of goodwill for impairment at December 31, 2011.

Salaries and employee benefits decreased from \$15.7 million in 2011 to \$13.9 million in 2012. This was a decrease of \$1.8 million or 11.36% and was the result of several factors. Decreased staffing occurred during 2011 and we started to realize the results of that reduction in 2012. In addition, we froze salaries for the year 2012 in order to control this expense. In the year 2012, we also lowered the 401-k matching contribution from matching dollar for dollar on the 5% employee contribution to 3%. On May 31, 2012 we merged eight existing offices together to form four offices which reduced our total number of branches to 23. Total full time equivalent employees have decreased to 286 at December 31, 2012 from 306 at December 31, 2011, a reduction of 20, or 6.54%.

Other real estate owned and repossessed asset expenses decreased \$1.1 million, or 20.06%, to \$4.5 million in 2012 from \$5.6 million in 2011. This decrease is related to a decrease in writedowns on other real estate owned during 2012 and a reduction of other real estate owned during

2012. We re-assessed the values of the properties in other

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real estate owned in 2012 and wrote down these assets by \$2.6 million to reflect fair market value changes in the properties since the original date that the assets were acquired in 2012 or the prior year balance for properties that continue to be held. During 2011 we wrote down these assets by \$4.0 million. In the year 2012, we had a net loss on the sale of other real estate owned property of \$480 thousand compared to a net loss of \$218 thousand in 2011.

In 2012, FDIC assessment expense decreased \$355 thousand, or 17.63%, from \$2.0 million in 2011 to \$1.7 million in 2012. This is the result of the reduction of total deposits during 2012.

The ratio of noninterest expense as a percentage of average assets decreased in 2012 to 4.35% as compared to 4.74% in 2011. We expect greater efficiencies to result as we maximize the performance of our branches and as the economy improves.

Our efficiency ratio, which is defined as noninterest expense divided by the sum of net interest income plus noninterest income, was 97.32% in 2012 as compared to 104.61% for 2011. Included in this calculation are the other real estate owned write-downs which significantly and negatively impact the ratio. We anticipate this ratio to improve in the future as we realize cost savings from staff reductions and the branch mergers that occurred in the second quarter of 2012. We believe that other real estate owned write-downs may reduce from the past as these have been primarily related to construction and development type properties that have been significantly impacted due to recent market valuation trends. Our level of these properties is much lower and reflects current market values.

### **Life Insurance**

We have life insurance policies on the life of one key officer and three former key officers. The Bank is the beneficiary under each policy. In addition, we own a policy in which the Bank is the beneficiary which was collateral for a defaulted loan. The aggregate total cash surrender value of the policies was \$12.0 million and \$11.4 million at December 31, 2012 and December 31, 2011, respectively. Total income for the policies during 2012 was \$309 thousand as compared to \$340 thousand for the year ending 2011.

### **Deferred Tax Asset and Income Taxes**

Due to timing differences between book and tax treatment of several income and expense items, a deferred tax asset of \$4.7 million existed at December 31, 2012 as compared to a deferred tax asset of \$7.2 million at December 31, 2011. The \$2.5 million difference is primarily related to a \$4.1 million deferred tax asset valuation allowance recorded in 2012, which increased the total valuation allowance to \$6.8 million at December 31, 2012, compared to \$2.7 million at December 31, 2011. Management reviewed the deferred tax calculation to determine the need for a valuation allowance. Based on the trend of reduced levels of earning assets and net interest income, we modified the projections of taxable income over the next three years and determined that an additional deferred tax asset valuation allowance was required during 2012. A valuation allowance is provided when it is more likely than not that some portion of the deferred tax asset will not be realized. In management's opinion, based on a three year taxable income projection, tax strategies which would result in potential securities gains and the effects of off-setting deferred tax liabilities, it is more likely than not that all the deferred tax assets, net of the \$6.8 million allowance, would be realizable. Included in deferred tax assets are the tax benefits derived from net operating loss carryforwards totaling \$4.6 million. Management expects to utilize all of these carryforwards prior to expiration. Direct charge-offs contributed to a reduction of the tax asset and are permitted as tax deductions. In addition, writedowns on other real estate owned property are expensed for book purposes but are not deductible for tax purposes until disposition of the property. Goodwill expense also was realized for book purposes in 2011 but continues to only be tax deductible based on the statutory requirements; thus, creating a deferred tax asset. When, and if, taxable income increases in the future and during the net operating loss carryforward period, this valuation allowance may be reversed and used to decrease tax obligations in the future. Our income tax expense was computed at the normal corporate income tax rate of 34% of taxable income included in net income. We do not have significant nontaxable income or nondeductible expenses.

After the common stock offering was concluded in December 2012, the Company evaluated whether a change of control as defined in Internal Revenue Code ( IRC ) section 382 had occurred. A change of control for purposes of IRC section 382 would have occurred if 50% or more of the ownership of the Company had changed as a result of the offering and stock transactions occurring in the preceding 3 years. In that case IRC section 382 would impose certain limitations which would restrict the ability of the Company to utilize the current amount of tax loss carryforwards among other future tax deductions. We concluded that a change of control did not occur under the IRC section 382. We must, however, continue to monitor any increase in the ownership of any 5% owner in the Company, of any new investors participating in the common stock offering that were not investors before the offering, and of any new 5% owner acquiring common stock from existing shareholders excluding the two aforementioned groups. If the combined additional ownership of these three groups ever causes their total ownership to exceed 50%





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in the next three years, the limitations of Internal Revenue Code 382 would apply. The Company is considering implementing a tax preservation plan in the near future to protect the ability to realize the future tax loss carryforwards that would help protect current investors from any such change of control under IRC section 382, if one should occur.

### **Capital Resources**

Our total capital at the end of 2012 was \$39.9 million compared to \$28.9 million in 2011. The increase was \$11.0 million, or 38.07%. In September 2012 we converted the notes payable to two Board members of \$5.5 million plus accrued interest of \$272 thousand to common stock, which resulted in an increase to capital of \$5.7 million. In December 2012 we successfully completed a public offering of our common stock, which resulted in an increase to capital of \$11.4 million. This \$17.9 million increase in capital was offset by the net loss of \$6.3 million for 2012, which was primarily the result of lower net interest income, provision for loan losses, other real estate owned property related expenses and the deferred tax asset valuation allowance expense. The Bank and the Company were both well capitalized as of December 31, 2012, as defined by the regulatory capital guidelines. New Peoples capital as a percentage of total assets was 5.54% at December 31, 2012 compared to 3.70% at December 31, 2011.

Total assets decreased in 2012 and we anticipate a slight decrease in assets to be the trend in 2013. Our primary source of capital comes from retained earnings. We developed a new strategic plan and capital plan in 2012. Under current economic conditions, we believe it is prudent to continue to increase capital to absorb potential losses that may occur if asset quality deteriorates further. We are aware that capital needs and requirements are affected by the level of problem assets, growth, earnings and other factors. Retained earnings are not alone sufficient to provide for this economic cycle and we believe we will need access to additional sources of capital. As part of our initiative to improve regulatory capital ratios, we are further reducing our higher risk assets, which results in a shrinking loan portfolio. Deposit growth is primarily focused on growing core deposits, which are mainly transaction accounts, commercial relationships and savings products. We are focused on improving earnings by maintaining a strong net interest margin and decreasing overhead expenses. We are fully implementing this strategy to increase capital. However, these efforts alone may not provide us adequate capital if further loan losses are realized.

No cash dividends have been paid historically and none are anticipated in the foreseeable future. Earnings will continue to be retained to build capital.

### **Liquidity**

We closely monitor our liquidity and have increased liquid assets in the form of cash, due from banks, federal funds sold, and unpledged available for sale investments from \$107.3 million at December 31, 2011 to \$125.3 million at December 31, 2012. We plan to maintain surplus short-term assets at levels adequate to meet potential liquidity needs during 2013.

At December 31, 2012, all of our investments are classified as available-for-sale, providing an additional source of liquidity in the amount of \$31.2 million, which is net of those securities pledged as collateral. This will primarily serve as a source of liquidity while yielding a higher return than other short term investment options, such as federal funds sold and overnight deposits with the Federal Reserve Bank. We have increased our investment portfolio from \$32.4 million at December 31, 2011 to \$49.6 million at December 31, 2012. Our strategy is to manage the portfolio with future purchases that reduce price risk in a rising interest rate environment and shorten the duration of these securities to be able to invest in higher yielding loans and investments when interest rates do rise again. We foresee purchasing additional securities in the near future as opportunities arise, and selling securities when it improves the portfolio strategies in a rising interest rate environment that may occur in the distant future.

Our loan to deposit ratio was 80.01% at December 31, 2012 and 84.40% at year end 2011. We anticipate this ratio to remain below 85% in the future. We can further lower the ratio as management deems appropriate by managing the rate of growth in our loan portfolio and by offering special promotions to entice new deposits. This can be done by changing interest rates charged or limiting the amount of new loans approved.

Available third party sources of liquidity remain intact at December 31, 2012 which includes the following: our line of credit with the Federal Home Loan Bank of Atlanta, the brokered certificates of deposit markets, internet certificates of deposit, and the discount window at the Federal Reserve Bank of Richmond.

At December 31, 2012, we had borrowings from the Federal Home Loan Bank totaling \$6.6 million as compared to \$18.0 million at December 31, 2011. None are overnight and subject to daily interest rate changes. The borrowings have a maturity date in the year 2018, but reduce in principal amounts monthly. The decrease of \$11.4 million was due to regularly scheduled principal payments and the early payoff of the term notes of \$10.2 million during the second quarter of 2012 that were to mature in the third quarter 2012. We incurred \$90 thousand in prepayment



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penalties during the second quarter as a result of this early payoff, but this early payoff was to realize savings in interest expense expected to be incurred through the maturity dates, netting savings to the overall earnings of the Company. We also used our line of credit with the Federal Home Loan Bank to issue a letter of credit for \$7.0 million in 2008 and \$3.0 million in 2010 to the Treasury Board of Virginia for collateral on public funds. An additional \$41.1 million was available on December 31, 2012 on the \$57.7 million line of credit which is secured by a blanket lien on our residential real estate loans.

We have access to the brokered deposits market. Currently we have \$2.7 million in 10 year term time deposits comprised of \$3 thousand incremental deposits which yield an interest rate of 4.10%. With the exception of CDARS time deposits, we have no other brokered deposits. Though this has not been a strategy in the past, we may utilize this source in the future as a lower cost source of funds.

We are a member of an internet certificate of deposit network whereby we may obtain funds from other financial institutions at auction. We may invest funds through this network as well. Currently, we only intend to use this source of liquidity in a liquidity crisis event.

The Bank has access to additional liquidity through the Federal Reserve Bank discount window for overnight funding needs. We may collateralize this line with investment securities and loans at our discretion; however, we do not anticipate using this funding source except as a last resort.

Additional liquidity is expected to be provided by loan repayments and core deposit growth that will result from an increase in market share in our targeted trade area.

With the increased asset liquidity and other external sources of funding, we believe at the Bank level we have adequate liquidity and capital resources to meet our requirements and needs for the foreseeable future. However, liquidity can be further affected by a number of factors such as counterparty willingness or ability to extend credit, regulatory actions and customer preferences, some of which are beyond our control.

Concerning the Company's liquidity, as a result of the public offering of common stock, we received net proceeds of \$11.4 million after \$624 thousand in offering expenses were paid. Upon receipt of the proceeds a \$7.0 million was injected into capital at the Bank, which left remaining funds of \$4.4 million at the Company. The remaining funds will be used to pay operating expenses, trust preferred interest payments (upon regulator approval), and provide additional capital injections to the Bank, if needed. As of now, all interest payments to the trust preferred securities is deferred. In the event, trust preferred interest payments are no longer deferred, then the Company has the cash to meet this obligation without any reliance on the Bank.

As a result of the conversion of director notes and the common stock offering, a total of 2,370,900 common stock warrants were issued. The warrants are immediately exercisable over the next five years at a price of \$1.75 per share. When, and if, these warrants are exercised, additional funds may be received by the Company, which provides potentially up to \$4.1 million in additional liquidity and capital at the Company level. Additional contingent funding sources will be explored as available.

**Financial Instruments with Off-Balance-Sheet Risk**

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

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

A summary of the contract amount of the Bank's exposure to off-balance-sheet risk as of December 31, 2012 and 2011 is as follows:

(Dollars in thousands)	2012	2011
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	\$ 27,887	\$ 29,004
Standby letters of credit	2,721	3,049



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Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing commercial properties.

Unfunded commitments under lines of credit are commitments for possible future extensions of credit to existing customers. Those lines of credit may not actually be drawn upon to the total extent to which the Bank is committed.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds certificates of deposit, deposit accounts, and real estate as collateral supporting those commitments for which collateral is deemed necessary.

**Interest Sensitivity**

At December 31, 2012 we had a negative cumulative gap rate sensitivity ratio of 31.67% for the one year re-pricing period, compared to 38.82% at December 31, 2011. A negative cumulative gap generally indicates that net interest income would improve in a declining interest rate environment as liabilities re-price more quickly than assets. Conversely, net interest income would probably decrease in periods during which interest rates are increasing. We are closely monitoring our position and implementing adjustments periodically to strategically position ourselves to enhance earnings in current and anticipated interest rate environments. On a quarterly basis, management reviews our interest rate risk and has decided that the current position is an acceptable risk.

<b>Interest Sensitivity Analysis</b>							
<b>December 31, 2012</b>							
(Dollars in thousands)							
	1- 90	91-365	1-3	4-5	6-15	Over 15	Total
	Days	Days	Years	Years	Years	Years	
<b>Uses of funds:</b>							
Loans	\$ 51,606	\$ 72,529	\$ 181,743	\$ 94,916	\$ 91,680	\$ 29,889	\$ 522,363
Federal funds sold	2						2
Deposits with banks	76,590						76,590
Investments	9,205		9,038	5,389	9,177	16,806	49,615
Bank owned life insurance	11,964						11,964
<b>Total earning assets</b>	<b>\$ 149,367</b>	<b>\$ 72,529</b>	<b>\$ 190,781</b>	<b>\$ 100,305</b>	<b>\$ 100,857</b>	<b>\$ 46,695</b>	<b>\$ 660,534</b>
<b>Sources of funds:</b>							
Interest Bearing DDA	\$ 68,665	\$	\$	\$	\$	\$	68,665
Savings & MMDA	113,280						113,280
Time Deposits	88,051	144,612	95,192	41,795	2,823		372,473
Trust preferred securities	16,496						16,496
Other borrowings					6,558		6,558
<b>Total interest bearing liabilities</b>	<b>\$ 286,492</b>	<b>\$ 144,612</b>	<b>\$ 95,192</b>	<b>\$ 41,795</b>	<b>\$ 9,381</b>	<b>\$</b>	<b>\$ 577,472</b>
<b>Discrete Gap</b>	<b>\$ (137,125)</b>	<b>\$ (72,083)</b>	<b>\$ 95,589</b>	<b>\$ 58,510</b>	<b>\$ 91,476</b>	<b>\$ 46,695</b>	<b>\$ 83,062</b>
<b>Cumulative Gap</b>	<b>\$ (137,125)</b>	<b>\$ (209,208)</b>	<b>\$ (113,619)</b>	<b>\$ (55,109)</b>	<b>\$ 36,367</b>	<b>\$ 83,062</b>	
	(20.76%)	(31.67%)	(17.20%)	(8.34%)	5.51%	12.57%	

Cumulative Gap as % of Total  
Earning Assets

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**  
Not applicable.

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**Item 8. Financial Statements and Supplementary Data**

**FINANCIAL STATEMENTS**

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders

New Peoples Bankshares, Inc.

Honaker, Virginia

We have audited the accompanying consolidated balance sheets of New Peoples Bankshares, Inc. and subsidiaries (the Company) as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income (loss), stockholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of New Peoples Bankshares, Inc. and subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

/s/ Elliott Davis, LLC

Richmond, Virginia

March 19, 2013

Elliott Davis LLC | Elliott Davis PLLC | [www.elliottdavis.com](http://www.elliottdavis.com)



**Table of Contents****NEW PEOPLES BANKSHARES, INC.****CONSOLIDATED BALANCE SHEETS****DECEMBER 31, 2012 AND 2011**

(IN THOUSANDS EXCEPT SHARE DATA)

	2012	2011
<b>ASSETS</b>		
Cash and due from banks	\$ 17,517	\$ 18,306
Interest-bearing deposits with banks	76,590	72,170
Federal funds sold	2	77
<b>Total Cash and Cash Equivalents</b>	<b>94,109</b>	<b>90,553</b>
Investment securities available-for-sale	49,615	32,434
Loans receivable	522,363	597,816
Allowance for loan losses	(16,810)	(18,380)
<b>Net Loans</b>	<b>505,553</b>	<b>579,436</b>
Bank premises and equipment, net	31,190	33,141
Equity securities (restricted)	2,803	3,573
Other real estate owned	13,869	15,092
Accrued interest receivable	2,374	3,067
Life insurance investments	11,964	11,351
Intangible assets	53	123
Deferred taxes, net	4,686	7,220
Other assets	2,799	4,394
<b>Total Assets</b>	<b>\$ 719,015</b>	<b>\$ 780,384</b>
<b>LIABILITIES</b>		
Deposits		
Demand deposits		
Noninterest bearing	\$ 98,432	\$ 109,629
Interest-bearing	68,665	58,459
Savings deposits	113,280	94,569
Time deposits	372,473	445,658
<b>Total Deposits</b>	<b>652,850</b>	<b>708,315</b>
FHLB advances	6,558	17,983
Accrued interest payable	1,880	1,796
Accrued expenses and other liabilities	1,365	1,471
Other borrowings	5,450	5,450
Trust preferred securities	16,496	16,496
<b>Total Liabilities</b>	<b>679,149</b>	<b>751,511</b>
<b>STOCKHOLDERS EQUITY</b>		
	43,731	20,020

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Common stock \$2.00 par value; 50,000,000 shares authorized; 21,865,535 and 10,010,178 shares issued and outstanding at December 31, 2012 and 2011, respectively

Common stock warrants	2,056	
Additional paid-in capital	13,081	21,689
Retained deficit	(19,409)	(13,085)
Accumulated other comprehensive income	407	249
<b>Total Stockholders Equity</b>	<b>39,866</b>	<b>28,873</b>
<b>Total Liabilities and Stockholders Equity</b>	<b>\$ 719,015</b>	<b>\$ 780,384</b>

The accompanying notes are an integral part of this statement.

**Table of Contents****NEW PEOPLES BANKSHARES, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS****FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

(IN THOUSANDS EXCEPT SHARE AND PER SHARE DATA)

	2012	2011
<b>INTEREST AND DIVIDEND INCOME</b>		
Loans including fees	\$ 32,592	\$ 41,176
Federal funds sold	3	9
Interest-earning deposits with banks	173	184
Investments	851	301
Dividends on equity securities (restricted)	114	99
<b>Total Interest and Dividend Income</b>	<b>33,733</b>	<b>41,769</b>
<b>INTEREST EXPENSE</b>		
Deposits		
Demand	110	155
Savings	242	460
Time deposits below \$100,000	2,994	4,768
Time deposits above \$100,000	2,024	2,949
FHLB advances	472	644
Other borrowings	128	194
Trust Preferred Securities	490	436
<b>Total Interest Expense</b>	<b>6,460</b>	<b>9,606</b>
<b>NET INTEREST INCOME</b>	<b>27,273</b>	<b>32,163</b>
<b>PROVISION FOR LOAN LOSSES</b>	<b>4,800</b>	<b>7,959</b>
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>22,473</b>	<b>24,204</b>
<b>NONINTEREST INCOME</b>		
Service charges	2,482	2,488
Fees, commission and other income	1,949	2,312
Insurance and investment fees	319	384
Net realized gains on sale of investment securities	537	
Life insurance investment income	309	340
<b>Total Noninterest Income</b>	<b>5,596</b>	<b>5,524</b>
<b>NONINTEREST EXPENSES</b>		
Salaries and employee benefits	13,947	15,735
Occupancy and equipment expenses	4,211	4,533
Advertising and public relations	472	445
Data processing and telecommunications	1,743	1,654

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FDIC insurance premiums	1,659	2,014
Other real estate owned and repossessed assets, net	4,458	5,577
Impairment of goodwill		4,122
Other operating expenses	5,498	5,342
<b>Total Noninterest Expenses</b>	<b>31,988</b>	<b>39,422</b>
<b>LOSS BEFORE INCOME TAXES</b>	<b>(3,919)</b>	<b>(9,694)</b>
<b>INCOME TAX EXPENSE (BENEFIT)</b>	<b>2,405</b>	<b>(784)</b>
<b>NET LOSS</b>	<b>\$ (6,324)</b>	<b>\$ (8,910)</b>
<b>Loss Per Share</b>		
Basic and Fully Diluted	\$ (0.57)	\$ (0.89)
<b>Average Weighted Shares of Common Stock</b>		
Basic and Fully Diluted	11,181,963	10,010,178

The accompanying notes are an integral part of this statement.

**Table of Contents****NEW PEOPLES BANKSHARES, INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

(IN THOUSANDS)

	2012	2011
<b>NET LOSS</b>	<b>\$ (6,324)</b>	<b>\$ (8,910)</b>
<b>Other comprehensive income (loss):</b>		
Investment securities activity:		
Unrealized gains arising during the year	777	394
Tax related to unrealized gains	(264)	(134)
Reclassification of realized gains during the year	(537)	
Tax related to realized gains	182	
<b>TOTAL OTHER COMPREHENSIVE INCOME</b>	<b>158</b>	<b>260</b>
<b>TOTAL COMPREHENSIVE LOSS</b>	<b>\$ (6,166)</b>	<b>\$ (8,650)</b>

The accompanying notes are an integral part of this statement.

**Table of Contents****NEW PEOPLES BANKSHARES, INC.****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY****FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

(IN THOUSANDS INCLUDING SHARE DATA)

	Shares of Common Stock	Common Stock	Common Stock Warrants	Additional Paid in Capital	Retained Deficit	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance, December 31, 2010	10,010	\$ 20,020	\$	\$ 21,689	\$ (4,175)	\$ (11)	\$ 37,523
Net loss					(8,910)		(8,910)
Unrealized gain on available-for-sale securities, net of \$134 tax						260	260
Balance, December 31, 2011	10,010	20,020		21,689	(13,085)	249	28,873
Net loss					(6,324)		(6,324)
Conversion of Director notes plus accrued interest	3,815	7,629	663	(2,570)			5,722
Common stock and common stock warrants issuance, net of costs of \$624	8,041	16,082	1,393	(6,038)			11,437
Realized gains on available-for-sale securities, net of \$182 tax						(355)	(355)
Unrealized gain on available-for-sale securities, net of \$264 tax						513	513
Balance, December 31, 2012	21,866	\$ 43,731	\$ 2,056	\$ 13,081	\$ (19,409)	\$ 407	\$ 39,866

The accompanying notes are an integral part of this statement.

**Table of Contents****NEW PEOPLES BANKSHARES, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

(IN THOUSANDS)

	2012	2011
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net loss	\$ (6,324)	\$ (8,910)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	2,500	2,562
Provision of loan losses	4,800	7,959
Impairment of goodwill		4,122
Income (less expenses) on life insurance	(613)	(340)
Gain on sale of securities available-for-sale	(537)	
Loss on sale of fixed assets	357	126
Loss on sale of foreclosed real estate	480	218
Adjustment of carrying value of foreclosed real estate	2,620	4,023
Accretion of bond premiums/discounts	572	70
Deferred tax expense	2,453	683
Amortization of core deposit intangible	70	101
Net change in:		
Interest receivable	693	633
Other assets	1,595	807
Accrued interest payable	356	76
Accrued expenses and other liabilities	(106)	(4)
Net Cash Provided by Operating Activities	8,916	12,126
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Net decrease in loans	59,108	82,453
Purchase of securities available-for-sale	(40,828)	(31,647)
Proceeds from sale and maturities of securities available-for-sale	23,851	4,195
Sale of Federal Home Loan Bank stock	770	305
Payments for the purchase of premises and equipment	(1,333)	(1,921)
Proceeds from sale of premises and equipment	427	233
Proceeds from sales of other real estate owned	8,098	5,945
Net Cash Provided by Investing Activities	50,093	59,563
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Issuance of common stock and common stock warrants	11,437	
Repayment of line of credit borrowings		(4,900)
Net increase in other borrowings		5,200
Repayments to Federal Home Loan Bank	(11,425)	(6,200)
Net change in:		
Demand deposits	(991)	20,227
Savings deposits	18,711	(13,550)
Time deposits	(73,185)	(64,442)
Net Cash Used in Financing Activities	(55,453)	(63,665)

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Net increase in cash and cash equivalents	3,556	8,024
Cash and Cash Equivalents, Beginning of the Year	90,553	82,529
Cash and Cash Equivalents, End of the Year	\$ 94,109	\$ 90,553
Supplemental Disclosure of Cash Paid During the Year for:		
Interest	\$ 6,544	\$ 9,682
Taxes	\$	\$
Supplemental Disclosure of Non Cash Transactions:		
Other real estate acquired in settlement of foreclosed loans	\$ 9,975	\$ 12,932
Loans made to finance sale of foreclosed real estate	\$	\$ 1,000
Conversion of Director notes in other borrowings to common stock	\$ 5,450	\$
Conversion of accrued interest payable on Director notes to common stock	\$ 272	\$
Common stock issued as a result of the conversion of Director notes	\$ 5,722	\$

The accompanying notes are an integral part of this statement.



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**NEW PEOPLES BANKSHARES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 NATURE OF OPERATIONS:**

**Nature of Operations** New Peoples Bankshares, Inc. ( The Company ) is a bank holding company whose principal activity is the ownership and management of a community bank. New Peoples Bank, Inc. ( The Bank ) was organized and incorporated under the laws of the Commonwealth of Virginia on December 9, 1997. The Bank commenced operations on October 28, 1998, after receiving regulatory approval. As a state chartered member bank, the Bank is subject to regulation by the Virginia Bureau of Financial Institutions, the Federal Deposit Insurance Corporation and the Federal Reserve Bank. The Bank provides general banking services to individuals, small and medium size businesses and the professional community of southwestern Virginia, southern West Virginia, and eastern Tennessee. On June 9, 2003, the Company formed two wholly owned subsidiaries, NPB Financial Services, Inc. and NPB Web Services, Inc. On July 7, 2004 the Company established NPB Capital Trust I for the purpose of issuing trust preferred securities. On September 27, 2006, the Company established NPB Capital Trust 2 for the purpose of issuing additional trust preferred securities. NPB Financial Services, Inc. was a subsidiary of the Company until January 1, 2009 when it became a subsidiary of the Bank. The name of NPB Financial Services, Inc. was changed in June 2012 to NPB Insurance Services, Inc. which will operate solely as an insurance agency.

**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:**

**Consolidation Policy** The consolidated financial statements include the Company, the Bank, NPB Insurance Services, Inc., and NPB Web Services, Inc. (Hereinafter, collectively referred to as The Company. ) All significant intercompany balances and transactions have been eliminated. In accordance with ASC 942, NPB Capital Trust I and 2 are not included in the consolidated financial statements.

**Use of Estimates** The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions.

**Cash and Cash Equivalents** Cash and cash equivalents as used in the cash flow statements include cash and due from banks, interest-bearing deposits with banks, and federal funds sold.

**Investment Securities** Management determines the appropriate classification of securities at the time of purchase. If management has the intent and the Company has the ability at the time of purchase to hold securities until maturity, they are classified as held to maturity and carried at amortized historical cost. Securities not intended to be held to maturity are classified as available for sale and carried at fair value. Securities available for sale are intended to be used as part of the Company's asset and liability management strategy and may be sold in response to changes in interest rates, prepayment risk or other similar factors.

The amortization of premiums and accretion of discounts are recognized in interest income using the effective interest method over the period to maturity. Realized gains and losses on dispositions are based on the net proceeds and the adjusted book value of the securities sold, using the specific identification method. Realized gains (losses) on securities available-for-sale are included in noninterest income and, when applicable, are reported as a reclassification adjustment, net of tax, in other comprehensive income. Unrealized gains and losses on investment securities available for sale are based on the difference between book value and fair value of each security. These gains and losses are credited or charged to other comprehensive income, net of tax, whereas realized gains and losses flow through the statement of operations.

**Loans** Loans are carried on the balance sheet at unpaid principal balance, net of any unearned interest and the allowance for loan losses. Interest income on loans is computed using the effective interest method, except where serious doubt exists as to the collectibility of the loan, in which case accrual of the income is discontinued.

It is the Company's policy to stop accruing interest on a loan, and classify that loan as non-accrual under the following circumstances: (a) whenever we are advised by the borrower that scheduled payment or interest payments cannot be met, (b) when our best judgment indicates that payment in full of principal and interest can no longer be expected, or (c) when any such loan or obligation becomes delinquent for 90 days unless it is both well secured and in the process of collection. All interest accrued but not collected for loans that are placed on nonaccrual or

charged off is reversed against interest income. The interest on these loans is accounted for on the cash basis or cost-

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recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and prospects for future contractual payments are reasonably assured.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

**Significant Group Concentrations of Credit Risk** The Company identifies a concentration as any obligation, direct or indirect, of the same or affiliated interests which represent 25% or more of the Company's capital structure, or \$10.0 million as of December 31, 2012. Most of the Company's activities are with customers located within the southwest Virginia, southern West Virginia, and northeastern Tennessee region. Certain concentrations may pose credit risk. The Company does not have any significant concentrations to any one industry or customer.

**Allowance for Loan Losses** The allowance for loan losses is maintained at a level that, in management's judgment, is adequate to absorb credit losses inherent in the loan portfolio. The loan portfolio is analyzed periodically and loans are assigned a risk rating. Allowances for impaired loans are generally determined based on collateral values or the present value of expected cash flows. A general allowance is made for all other loans not considered impaired as deemed appropriate by management. In determining the adequacy of the allowance, management considers the following factors: the nature of the portfolio, credit concentrations, trends in historical loss experience, specific impaired loans, the estimated value of any underlying collateral, prevailing environmental factors and economic conditions, and other inherent risks. While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in collateral values and changes in estimates of cash flows on impaired loans. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance is increased by a provision for loan losses, which is charged to expense and reduced by charge-offs, net of recoveries. Loans are charged against the allowance for loan losses when management believes that collectability of all or part of the principal is unlikely. Past due status is determined based on contractual terms.

In regards to its consumer loans and consumer real estate loan portfolio, the Company uses a conservative approach for its risk grading and timing of charge offs on these loans. This approach is based on the guidance found in the Uniform Retail Credit Classification and Account Management Policy and as a result affects our estimate of the allowance for loan losses. Under this approach when a consumer loan or consumer real estate loan is originated, it must possess qualities of a credit risk grade of Pass for approval and will remain with the initial risk rating through maturity unless there is a deterioration in the credit quality of the loan. Subsequently, if the loan becomes contractually 90 days past due or the borrower files for bankruptcy protection, it is downgraded to Substandard. At 90 days past due, or earlier if the customer has filed bankruptcy, the collateral value less estimated liquidation costs is compared to the loan balance to calculate any potential deficiency. If there is sufficient collateral, no charge-off is necessary. If there is a deficiency, then within 30 days of the loan becoming 90 days past due, or within 60 days of bankruptcy notice, the deficiency is charged-off against the allowance for loan loss. If the loan is unsecured, upon being deemed Substandard, the entire loan amount is charged off. Collection efforts continue by means of repossessions or foreclosures, and upon bank ownership, liquidation ensues.

**Other Real Estate Owned** Other real estate owned represents properties acquired through foreclosure or deed taken in lieu of foreclosure. At the time of acquisition, these properties are recorded at the lower of cost or fair value less estimated costs to sell. Expenses incurred in connection with operating these properties and subsequent write-downs, if any, are charged to expense. Subsequent to foreclosure, management periodically considers the adequacy of the reserve for losses on the property. Gains and losses on the sales of these properties are credited or charged to income in the year of the sale.

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**Bank Premises and Equipment** Land, buildings and equipment are recorded at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the following estimated useful lives:

	Type	Estimated useful life
Buildings		39 years
Paving and landscaping		15 years
Computer equipment and software		3 to 5 years
Vehicles		5 years
Furniture and other equipment		5 to 7 years

**Stock Options** The Company records compensation related to stock options pursuant to ASC 718 which requires the estimated fair market value of the expense to be reflected over the period the award is earned which is presumed to be the vesting period. For additional discussion concerning stock options see Note 15, Stock Option Plan.

**Common Stock Warrants** The company issued common stock warrants as a result of its conversion of Director notes and the completion of its common stock offering in 2012. For additional discussion concerning these transactions including the terms and value of the warrants, see Note 22, Capital.

**Income Taxes** Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. If all or a portion of the net deferred tax asset is determined to be unlikely to be realized, a valuation allowance is established to reduce the net deferred tax asset to the amount that is more likely than not to be realized.

In the event the Company has unrecognized tax expense in future accounting periods, the Company will recognize interest in interest expense and penalties in operating expenses. There were no interest or penalties related to an unrecognized tax position for the years ended December 31, 2012 and 2011. Because of the impact of deferred tax accounting, other than interest and penalties, the reversal of the Company's treatment by taxing authorities would not affect the annual effective tax rate but would defer or accelerate the payment of cash to the taxing authority. The Company's tax filings for years ended 2009 through 2012 are currently open to audit under statutes of limitations by the Internal Revenue Service ( IRS ) and the Virginia Department of Taxation. Our tax filings for the years ended 2010 and 2011 are currently under examination by the IRS.

**Financial Instruments - Off-balance-sheet instruments** In the ordinary course of business, the Company has entered into commitments to extend credit. Such financial instruments are recorded in the financial statements when they are funded.

**Comprehensive Income** Generally accepted accounting principles require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

**Earnings Per Share** Basic earnings per share computations are based on the weighted average number of shares outstanding during each year. Dilutive earnings per share reflects the additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued relate to outstanding options and common stock warrants and are determined by the Treasury Method. For the years ending December 31, 2012 and 2011, potential common shares were anti-dilutive and were not included in the calculation. Basic and diluted net loss per common share calculations follows:

(Amounts in Thousands, Except

Share and Per Share Data)	For the years ended	
	December 31,	
	2012	2011
Net loss available to common shareholders	\$ (6,324)	\$ (8,910)
Weighted average shares outstanding	11,181,963	10,010,178

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Weighted average dilutive shares outstanding	11,181,963	10,010,178
Basic and diluted loss per share	\$ (0.57)	\$ (0.89)

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**Advertising Cost** Advertising costs are expensed in the period incurred.

**Business Combinations** For purchase acquisitions accounted for as a business combination, the Company is required to record the assets acquired, including identified intangible assets and liabilities assumed at their fair value, which in many instances involves estimates based on third party valuations, such as appraisals, or internal valuations based on discounted cash flow analyses or other valuation techniques. The determination of the useful lives of intangible assets is subjective, as is the appropriate amortization method for such intangible assets. In addition, purchase acquisitions may result in goodwill, which is subject to ongoing periodic impairment testing based on the fair value of net assets acquired compared to the carrying value of goodwill. Changes in acquisition multiples, the overall interest rate environment, or the continuing operations of the assets acquired could have a significant impact on the periodic impairment testing. For additional discussion concerning our valuation of intangible assets, see Note 13, Intangible Assets.

**Reclassification** Certain reclassifications have been made to the prior years' financial statements to place them on a comparable basis with the current year. Net income and stockholders' equity previously reported were not affected by these reclassifications.

**Subsequent Events** The Company has evaluated subsequent events for potential recognition and/or disclosure through the date these consolidated financial statements were issued.

**NOTE 3 FORMAL WRITTEN AGREEMENT:**

Effective July 29, 2010, the Company and the Bank entered into a written agreement with the Federal Reserve Bank of Richmond ( Reserve Bank ) and the Virginia State Corporation Commission Bureau of Financial Institutions (the Bureau ) called (the Written Agreement ). At December 31, 2012, we believe we have not yet achieved full compliance with the Written Agreement but we have made progress in our compliance efforts under the Written Agreement and all of the written plans required to date, as discussed in the following paragraphs, have been submitted on a timely basis.

Under the terms of the Written Agreement, the Bank has agreed to develop and submit for approval within specified time periods written plans to: (a) strengthen board oversight of management and the Bank's operation; (b) if appropriate after review, to strengthen the Bank's management and board governance; (c) strengthen credit risk management policies; (d) enhance lending and credit administration; (e) enhance the Bank's management of commercial real estate concentrations; (f) conduct ongoing review and grading of the Bank's loan portfolio; (g) improve the Bank's position with respect to loans, relationships, or other assets in excess of \$1 million which are now or in the future become past due more than 90 days, which are on the Bank's problem loan list, or which are adversely classified in any report of examination of the Bank; (h) review and revise, as appropriate, current policy and maintain sound processes for maintaining an adequate allowance for loan and lease losses; (i) enhance management of the Bank's liquidity position and funds management practices; (j) revise its contingency funding plan; (k) revise its strategic plan; and (l) enhance the Bank's anti-money laundering and related activities.

In addition, the Bank has agreed that it will: (a) not extend, renew, or restructure any credit that has been criticized by the Reserve Bank or the Bureau absent prior board of directors approval in accordance with the restrictions in the Written Agreement; (b) eliminate all assets or portions of assets classified as loss and thereafter charge off all assets classified as loss in a federal or state report of examination, unless otherwise approved by the Reserve Bank.

Under the terms of the Written Agreement, both the Company and the Bank have agreed to submit capital plans to maintain sufficient capital at the Company, on a consolidated basis, and the Bank, on a stand-alone basis, and to refrain from declaring or paying dividends without prior regulatory approval. The Company has agreed that it will not take any other form of payment representing a reduction in the Bank's capital or make any distributions of interest, principal, or other sums on subordinated debentures or trust preferred securities without prior regulatory approval. The Company may not incur, increase or guarantee any debt without prior regulatory approval and has agreed not to purchase or redeem any shares of its stock without prior regulatory approval.

Under the terms of the Written Agreement, the Company and the Bank have appointed a committee to monitor compliance with the Written Agreement. The directors of the Company and the Bank have recognized and unanimously agree with the common goal of financial soundness represented by the Written Agreement and have confirmed the intent of the directors and executive management to diligently seek to comply with all requirements of the Written Agreement.

**Table of Contents****NOTE 4 DEPOSITS IN AND FEDERAL FUNDS SOLD TO BANKS:**

The Bank had federal funds sold and cash on deposit with other commercial banks amounting to \$76.6 million and \$72.3 million at December 31, 2012 and 2011, respectively. Deposit amounts at other commercial banks may, at times, exceed federally insured limits.

The Bank is required to maintain average reserve balances, computed by applying prescribed percentages to its various types of deposits, either at the Bank or on deposit with the Federal Reserve Bank. At December 31, 2012 and 2011, all required reserves were met by the Bank's vault cash.

**NOTE 5 INVESTMENT SECURITIES:**

The amortized cost and estimated fair value of securities (all available-for-sale) are as follows:

(Dollars are in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Approximate Fair Value
<b>December 31, 2012</b>				
U.S. Government Agencies	\$ 23,177	\$ 473	\$ 13	\$ 23,637
Mortgage backed securities	\$ 25,822	\$ 210	\$ 54	\$ 25,978
<b>Total Securities AFS</b>	<b>\$ 48,999</b>	<b>\$ 683</b>	<b>\$ 67</b>	<b>\$ 49,615</b>
<b>December 31, 2011</b>				
U.S. Government Agencies	\$ 21,405	\$ 238	\$ 10	\$ 21,633
Taxable municipals	\$ 1,465	\$ 89	\$ 2	\$ 1,552
Tax-exempt municipals	\$ 1,043	\$ 11	\$	\$ 1,054
Mortgage backed securities	\$ 8,144	\$ 67	\$ 16	\$ 8,195
<b>Total Securities AFS</b>	<b>\$ 32,057</b>	<b>\$ 405</b>	<b>\$ 28</b>	<b>\$ 32,434</b>

The following table details unrealized losses and related fair values in the available-for-sale portfolio. This information is aggregated by the length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2012 and December 31, 2011.

(Dollars are in thousands)	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>December 31, 2012</b>						
U.S. Government Agencies	\$ 2,931	\$ 13	\$	\$	\$ 2,931	\$ 13
Mtg. backed securities	7,491	54			7,491	54
<b>Total Securities AFS</b>	<b>\$ 10,422</b>	<b>\$ 67</b>	<b>\$</b>	<b>\$</b>	<b>\$ 10,422</b>	<b>\$ 67</b>
<b>December 31, 2011</b>						
U.S. Government Agencies	\$ 5,592	\$ 10	\$	\$	\$ 5,592	\$ 10
Taxable municipals	572	2			572	2
Mtg. backed securities	4,055	16			4,055	16
<b>Total Securities AFS</b>	<b>\$ 10,219</b>	<b>\$ 28</b>	<b>\$</b>	<b>\$</b>	<b>\$ 10,219</b>	<b>\$ 28</b>

At December 31, 2012, the available-for-sale portfolio included ten investments for which the fair market value was less than amortized cost. At December 31, 2011, the available-for-sale portfolio included eleven investments for which the fair market value was less than amortized cost. Management evaluates securities for other than temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial conditions and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. No securities had an other than temporary impairment.



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The amortized cost and fair value of investment securities at December 31, 2012, by contractual maturity, are shown in the following schedule. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollars are in thousands)

	Amortized Cost	Fair Value	Weighted Average Yield
Securities Available for Sale			
Due in one year or less	\$	\$	%
Due after one year through five years	1,479	1,489	1.00%
Due after five years through fifteen years	12,240	12,357	1.46%
Due after fifteen years	35,280	35,769	1.93%
<b>Total</b>	<b>\$ 48,999</b>	<b>\$ 49,615</b>	<b>1.78%</b>

Investment securities with a carrying value of \$18.4 million and \$15.7 million at December 31, 2012 and 2011, were pledged to secure public deposits, overnight payment processing and for other purposes required by law.

The Bank, as a member of the Federal Reserve Bank and the Federal Home Loan Bank, is required to hold stock in each. These equity securities are restricted from trading and are recorded at a cost of \$2.8 million and \$3.6 million as of December 31, 2012 and 2011, respectively.

**NOTE 6 LOANS:**

Loans receivable outstanding at December 31, are summarized as follows:

(Dollars are in thousands)

	2012	2011
Real estate secured:		
Commercial	\$ 149,935	\$ 170,789
Construction and land development	24,327	32,389
Residential 1-4 family	240,201	255,998
Multifamily	12,567	14,320
Farmland	33,068	40,106
<b>Total real estate loans</b>	<b>460,098</b>	<b>513,602</b>
Commercial	28,314	39,327
Agriculture	4,328	6,147
Consumer installment loans	29,445	38,522
All other loans	178	218
<b>Total loans</b>	<b>\$ 522,363</b>	<b>\$ 597,816</b>

Loans receivable on nonaccrual status at December 31, are summarized as follows:

(Dollars are in thousands)

	2012	2011
Real estate secured:		
Commercial	\$ 16,308	\$ 19,169
Construction and land development	2,412	5,583
Residential 1-4 family	3,403	4,829

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Multifamily	442	2,101
Farmland	7,750	5,257
<b>Total real estate loans</b>	<b>30,315</b>	<b>36,939</b>
Commercial	2,762	4,522
Agriculture	450	854
Consumer installment loans	9	1
All other loans		
 Total loans receivable on nonaccrual status	 \$ 33,536	 \$ 42,316

Total interest income not recognized on nonaccrual loans for 2012 and 2011 was \$1.4 million and \$1.3 million, respectively. Total interest income recognized on nonaccrual loans for 2012 and 2011 was \$865 thousand and \$1.1 million, respectively.

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The following table presents information concerning the Company's investment in loans considered impaired as of December 31, 2012 and December 31, 2011:

<b>As of December 31, 2012</b>	Average Recorded Investment	Interest Income Recognized	Recorded Investment	Unpaid Principal Balance	Related Allowance
(Dollars are in thousands)					
<b>With no related allowance recorded:</b>					
Real estate secured:					
Commercial	\$ 26,662	\$ 829	\$ 20,389	\$ 21,434	\$
Construction and land development	4,759	118	3,759	8,618	
Residential 1-4 family	7,824	227	6,308	6,567	
Multifamily	1,021	44	928	998	
Farmland	7,748	168	4,375	4,810	
Commercial	2,499	18	1,111	1,147	
Agriculture	463	7	109	109	
Consumer installment loans	83	10	98	98	
All other loans					
<b>With an allowance recorded:</b>					
Real estate secured:					
Commercial	14,770	347	13,495	14,014	3,196
Construction and land development	1,728	41	793	945	177
Residential 1-4 family	5,473	203	3,830	3,836	577
Multifamily	1,589	68	2,028	2,096	456
Farmland	4,972	(123)	5,702	5,714	635
Commercial	1,689	19	1,881	1,885	491
Agriculture	373	3	353	353	308
Consumer installment loans	69	3	27	27	16
All other loans					
<b>Total</b>	<b>\$ 81,722</b>	<b>\$ 1,982</b>	<b>\$ 65,186</b>	<b>\$ 72,651</b>	<b>\$ 5,856</b>

<b>As of December 31, 2011</b>	Average Recorded Investment	Interest Income Recognized	Recorded Investment	Unpaid Principal Balance	Related Allowance
(Dollars are in thousands)					
<b>With no related allowance recorded:</b>					
Real estate secured:					
Commercial	\$ 32,370	\$ 1,356	\$ 31,633	\$ 33,175	\$
Construction and land development	14,288	125	6,954	12,838	
Residential 1-4 family	6,406	315	8,221	8,296	
Multifamily	619	31	613	613	
Farmland	13,005	435	10,364	10,554	
Commercial	2,958	60	3,529	4,070	
Agriculture	396	1	521	817	
Consumer installment loans	4	1	9	9	
All other loans					
<b>With an allowance recorded:</b>					
Real estate secured:					
Commercial	9,887	691	14,482	14,973	2,794
Construction and land development	2,917	87	2,289	2,310	474
Residential 1-4 family	5,111	277	6,473	6,764	1,052
Multifamily					
Farmland	2,354	119	4,192	4,192	605

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Commercial	1,982	75	1,857	1,857	649
Agriculture	758	28	641	641	448
Consumer installment loans	41	3	43	43	24
All other loans					
Total	\$ 93,096	\$ 3,604	\$ 91,821	\$ 101,152	\$ 6,046

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An age analysis of past due loans receivable was as follows:

	Loans				Total Past Due Loans	Current Loans	Total Loans	Accruing
	Loans	Loans	Loans	Loans				Loans
	30-59	60-89	90 or	90 or				90 or
	Days	Days	More	More				More
<b>As of December 31, 2012</b>	Past	Past	Past	Past			Past	
(Dollars are in thousands)	Due	Due	Due	Due	Loans	Loans	Due	
<b>Real estate secured:</b>								
Commercial	\$ 4,164	\$ 998	\$ 8,889	\$ 14,051	\$ 135,884	\$ 149,935	\$	
Construction and land development	653		254	907	23,420	24,327		
Residential 1-4 family	9,031	861	3,027	12,919	227,282	240,201	304	
Multifamily	90		442	532	12,035	12,567		
Farmland	1,777		5,871	7,648	25,420	33,068	191	
<b>Total real estate loans</b>	<b>15,715</b>	<b>1,859</b>	<b>18,483</b>	<b>36,057</b>	<b>424,041</b>	<b>460,098</b>	<b>495</b>	
Commercial	135	12	2,104	2,251	26,063	28,314	2	
Agriculture	117	12	360	489	3,839	4,328		
Consumer installment Loans	506	66	55	627	28,818	29,445	54	
All other loans	19	7		26	152	178		
<b>Total loans</b>	<b>\$ 16,492</b>	<b>\$ 1,956</b>	<b>\$ 21,002</b>	<b>\$ 39,450</b>	<b>\$ 482,913</b>	<b>\$ 522,363</b>	<b>\$ 551</b>	

	Loans				Total Past Due Loans	Current Loans	Total Loans	Accruing
	Loans	Loans	Loans	Loans				Loans
	30-59	60-89	90 or	90 or				90 or
	Days	Days	More	More				More
<b>As of December 31, 2011</b>	Past	Past	Past	Past			Past	
(Dollars are in thousands)	Due	Due	Due	Due	Loans	Loans	Due	
<b>Real estate secured:</b>								
Commercial	\$ 9,754	\$ 2,294	\$ 7,771	\$ 19,819	\$ 150,970	\$ 170,789	\$	
Construction and land development	595	238	5,280	6,113	26,276	32,389		
Residential 1-4 family	9,471	1,412	4,101	14,984	241,014	255,998	1,129	
Multifamily		1,777	218	1,995	12,325	14,320		
Farmland	2,841	624	3,800	7,265	32,841	40,106		
<b>Total real estate loans</b>	<b>22,661</b>	<b>6,345</b>	<b>21,170</b>	<b>50,176</b>	<b>463,426</b>	<b>513,602</b>	<b>1,129</b>	
Commercial	551	34	2,938	3,523	35,804	39,327	117	
Agriculture	268	88	458	814	5,333	6,147	3	
Consumer installment Loans	822	133	221	1,176	37,346	38,522	222	
All other loans	26	9	33	68	150	218	33	
<b>Total loans</b>	<b>\$ 24,328</b>	<b>\$ 6,609</b>	<b>\$ 24,820</b>	<b>\$ 55,757</b>	<b>\$ 542,059</b>	<b>\$ 597,816</b>	<b>\$ 1,504</b>	

The Company categorizes loans receivable into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans and leases individually by classifying the loans receivable as to credit risk. The Company uses the following definitions for risk ratings:

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**Pass** Loans in this category are considered to have a low likelihood of loss based on relevant information analyzed about the ability of the borrowers to service their debt and other factors.

**Special Mention** Loans in this category are currently protected but are potentially weak, including adverse trends in borrower's operations, credit quality or financial strength. Those loans constitute an undue and unwarranted credit risk but not to the point of justifying a substandard classification. The credit risk may be relatively minor yet constitute an unwarranted risk in light of the circumstances. Special mention loans have potential weaknesses which may, if not checked or corrected, weaken the loan or inadequately protect the Company's credit position at some future date.

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

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**Doubtful** Loans classified Doubtful have all the weaknesses inherent in loans classified Substandard, plus the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions, and values highly questionable and improbable.

Based on the most recent analysis performed, the risk category of loans receivable was as follows:

**As of December 31, 2012**

(Dollars are in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
<b>Real estate secured:</b>					
Commercial	\$ 117,945	\$ 5,782	\$ 26,120	\$ 88	\$ 149,935
Construction and land development	18,502	1,067	4,758		24,327
Residential 1-4 family	220,534	4,739	14,437	491	240,201
Multifamily	9,765	178	2,624		12,567
Farmland	21,560	1,247	10,261		33,068
<b>Total real estate loans</b>	<b>388,306</b>	<b>13,013</b>	<b>58,200</b>	<b>579</b>	<b>460,098</b>
Commercial	21,793	3,227	3,254	40	28,314
Agriculture	3,841	53	434		4,328
Consumer installment loans	29,159	21	261	4	29,445
All other loans	178				178
<b>Total</b>	<b>\$ 443,277</b>	<b>\$ 16,314</b>	<b>\$ 62,149</b>	<b>\$ 623</b>	<b>\$ 522,363</b>

**As of December 31, 2011**

(Dollars are in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
<b>Real estate secured:</b>					
Commercial	\$ 112,694	\$ 18,377	\$ 39,573	\$ 145	\$ 170,789
Construction and land development	23,203	1,224	7,962		32,389
Residential 1-4 family	209,863	17,137	27,730	1,268	255,998
Multifamily	11,727	1,909	684		14,320
Farmland	21,715	4,957	13,022	412	40,106
<b>Total real estate loans</b>	<b>379,202</b>	<b>43,604</b>	<b>88,971</b>	<b>1,825</b>	<b>513,602</b>
Commercial	32,018	2,045	4,227	1,037	39,327
Agriculture	4,743	678	726		6,147
Consumer installment loans	36,107	900	1,484	31	38,522
All other loans	218				218
<b>Total</b>	<b>\$ 452,288</b>	<b>\$ 47,227</b>	<b>\$ 95,408</b>	<b>\$ 2,893</b>	<b>\$ 597,816</b>

**Table of Contents****NOTE 7 ALLOWANCE FOR LOAN LOSSES:**

The following table details activity in the allowance for loan losses by portfolio segment for the period ended December 31, 2012. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

As of December 31, 2012

(Dollars are in thousands)	Beginning Balance	Charge Offs	Recoveries	Advances	Provisions	Ending Balance
<b>Real estate secured:</b>						
Commercial	\$ 5,671	\$ (2,845)	\$ 61	\$	\$ 3,833	\$ 6,720
Construction and land development	3,848	(357)	73		(1,398)	2,166
Residential 1-4 family	3,759	(1,615)	87		819	3,050
Multifamily	148	(75)			479	552
Farmland	951	(577)			700	1,074
<b>Total real estate loans</b>	<b>14,377</b>	<b>(5,469)</b>	<b>221</b>		<b>4,433</b>	<b>13,562</b>
Commercial	1,883	(942)	86		745	1,772
Agriculture	486	(4)	11		40	533
Consumer installment loans	781	(336)	63		(120)	388
All other loans	2				2	4
Unallocated	851				(300)	551
<b>Total</b>	<b>\$ 18,380</b>	<b>\$ (6,751)</b>	<b>\$ 381</b>	<b>\$</b>	<b>\$ 4,800</b>	<b>\$ 16,810</b>

As of December 31, 2012	Allowance for Loan Losses			Recorded Investment in Loans		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
(Dollars are in thousands)						
<b>Real estate secured:</b>						
Commercial	\$ 3,196	\$ 3,524	\$ 6,720	\$ 33,884	\$ 116,051	\$ 149,935
<b>Construction and land</b>						
development	177	1,989	2,166	4,552	19,775	24,327
Residential 1-4 family	577	2,473	3,050	10,138	230,063	240,201
Multifamily	456	96	552	2,956	9,611	12,567
Farmland	635	439	1,074	10,077	22,991	33,068
<b>Total real estate loans</b>	<b>5,041</b>	<b>8,521</b>	<b>13,562</b>	<b>61,607</b>	<b>398,491</b>	<b>460,098</b>
Commercial	491	1,281	1,772	2,992	25,322	28,314
Agriculture	308	225	533	462	3,866	4,328
Consumer installment loans	16	372	388	125	29,320	29,445
All other loans		4	4		178	178
Unallocated		551	551			
<b>Total</b>	<b>\$ 5,856</b>	<b>\$ 10,954</b>	<b>\$ 16,810</b>	<b>\$ 65,186</b>	<b>\$ 457,177</b>	<b>\$ 522,363</b>



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The following table details activity in the allowance for loan losses by portfolio segment for the period ended December 31, 2011. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

**As of December 31, 2011**

(Dollars are in thousands)	Beginning Balance	Charge Offs	Recoveries	Advances	Provisions	Ending Balance
<b>Real estate secured:</b>						
Commercial	\$ 5,141	\$ (4,147)	\$ 877	\$	\$ 3,800	\$ 5,671
Construction and land development	4,913	(7,245)	1,296	153	4,731	3,848
Residential 1-4 family	1,699	(1,299)	141		3,218	3,759
Multifamily	42				106	148
Farmland	922	(511)	66		474	951
<b>Total real estate loans</b>	<b>12,717</b>	<b>(13,202)</b>	<b>2,380</b>	<b>153</b>	<b>12,329</b>	<b>14,377</b>
Commercial	3,281	(2,480)	140		942	1,883
Agriculture	1,120	(1,031)	18		379	486
Consumer installment loans	1,733	(694)	123		(381)	781
All other loans					2	2
Unallocated	6,163				(5,312)	851
<b>Total</b>	<b>\$ 25,014</b>	<b>\$ (17,407)</b>	<b>\$ 2,661</b>	<b>\$ 153</b>	<b>\$ 7,959</b>	<b>\$ 18,380</b>

<b>As of December 31, 2011</b>	Allowance for Loan Losses			Recorded Investment in Loans		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
<b>Real estate secured:</b>						
Commercial	\$ 2,794	\$ 2,877	\$ 5,671	\$ 46,115	\$ 124,674	\$ 170,789
Construction and land development	474	3,374	3,848	9,243	23,146	32,389
Residential 1-4 family	1,052	2,707	3,759	14,694	241,304	255,998
Multifamily		148	148	613	13,707	14,320
Farmland	605	346	951	14,556	25,550	40,106
<b>Total real estate loans</b>	<b>4,925</b>	<b>9,452</b>	<b>14,377</b>	<b>85,221</b>	<b>428,381</b>	<b>513,602</b>
Commercial	649	1,234	1,883	5,386	33,941	39,327
Agriculture	448	38	486	1,162	4,985	6,147
Consumer installment loans	24	757	781	52	38,470	38,522
All other loans		2	2		218	218
Unallocated		851	851			
<b>Total</b>	<b>\$ 6,046</b>	<b>\$ 12,334</b>	<b>\$ 18,380</b>	<b>\$ 91,821</b>	<b>\$ 505,995</b>	<b>\$ 597,816</b>

In determining the amount of our allowance, we rely on an analysis of our loan portfolio, our experience and our evaluation of general economic conditions, as well as the requirements of the written agreement and other regulatory input. If our assumptions prove to be incorrect, our current allowance may not be sufficient to cover future loan losses and we may experience significant increases to our provision.

**Table of Contents****NOTE 8 TROUBLED DEBT RESTRUCTURINGS:**

At December 31, 2012 there were \$20.0 million in loans that are classified as troubled debt restructurings compared to \$29.1 million at December 31, 2011. The following table presents information related to loans modified as troubled debt restructurings during the years ended December 31, 2012 and 2011.

Troubled Debt Restructurings	December 31, 2012			December 31, 2011		
	# of Loans	Pre-Mod. Recorded Investment	Post-Mod. Recorded Investment	# of Loans	Pre-Mod. Recorded Investment	Post-Mod. Recorded Investment
(Dollars are in thousands)						
Real estate secured:						
Commercial	6	\$ 792	\$ 783	14	\$ 14,651	\$ 14,321
Construction and land Development				2	179	176
Residential 1-4 family	32	1,602	1,497	14	2,914	2,893
Multifamily				2	454	452
Farmland						
<b>Total real estate loans</b>	<b>38</b>	<b>2,394</b>	<b>2,280</b>	<b>32</b>	<b>18,198</b>	<b>17,842</b>
Commercial				6	1,111	1,081
Agriculture				2	390	390
Consumer installment loans	2	23	16	9	168	155
All other loans						
<b>Total</b>	<b>40</b>	<b>\$ 2,417</b>	<b>\$ 2,296</b>	<b>49</b>	<b>\$ 19,867</b>	<b>\$ 19,468</b>

During the year ended 2012, the Company modified 40 loans that were considered to be troubled debt restructurings. We modified the terms for 6 of these loans and the interest rate was lowered for 32 of these loans. On 2 loans we modified the terms and lowered the interest rate. During the year ended 2011, the Company modified 49 loans that were considered to be troubled debt restructurings. We modified the terms for 25 of these loans and the interest rate was lowered for 9 of these loans. On 15 loans we modified the terms and lowered the interest rate.

The following table presents information related to loans modified as a troubled debt restructurings that subsequently defaulted during the years ended December 31, 2012 and 2011, and within twelve months of their modification date. A troubled debt restructuring is considered to be in default once it becomes 90 days or more past due following a modification.

## Troubled Debt Restructurings

That Subsequently Defaulted  
During the Period

	December 31, 2012		December 31, 2011	
	# of Loans	Recorded Investment	# of Loans	Recorded Investment
(Dollars are in thousands)				
Real estate secured:				
Commercial	4	\$ 1,764	3	\$ 1,691
Construction and land development				
Residential 1-4 family	3	290	1	113
Multifamily	1			
Farmland				
<b>Total real estate loans</b>	<b>8</b>	<b>2,054</b>	<b>4</b>	<b>1,804</b>
Commercial				
Agriculture	1	300		
Consumer installment loans				
All other loans				

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Total	9	\$ 2,354	4	\$ 1,804
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In determination of the allowance for loan losses, management considers troubled debt restructurings and subsequent defaults in these restructurings in its estimate. The Company evaluates all troubled debt restructurings for possible further impairment. As a result, the allowance may be increased, adjustments may be made in the allocation of the allowance, or charge-offs may be taken to further writedown the carrying value of the loan.

**Table of Contents****NOTE 9 BANK PREMISES AND EQUIPMENT:**

Bank premises and equipment at December 31, are summarized as follows:

(Dollars are in thousands)	2012	2011
Land	\$ 10,171	\$ 10,421
Buildings and improvements	23,468	24,043
Furniture and equipment	15,129	13,874
Vehicles	514	504
Construction in progress	232	232
	49,514	49,074
Less accumulated depreciation	(18,324)	(15,933)
Bank Premises and Equipment	\$ 31,190	\$ 33,141

Depreciation expense for 2012 and 2011 was \$2.5 million and \$2.6 million, respectively.

**NOTE 10 OTHER TIME DEPOSITS:**

The aggregate amount of time deposits with a minimum denomination of \$100,000 was \$139.5 million and \$167.2 million at December 31, 2012 and 2011, respectively. We have brokered deposits totaling \$2.7 million at December 31, 2012 and 2011, respectively. At December 31, 2012, the scheduled maturities of time deposits are as follows (dollars are in thousands):

2013	\$ 232,936
2014	48,929
2015	45,859
2016	27,554
2017	14,372
After five years	2,823
Total	\$ 372,473

**Table of Contents****NOTE 11 INCOME TAX EXPENSE (BENEFIT):**

The components of income tax expense for the years ended December 31, are as follows:

(Dollars are in thousands)	2012	2011
Current benefit	\$ (48)	\$ (1,467)
Deferred tax expense	2,453	683
<b>Net income tax expense (benefit)</b>	<b>\$ 2,405</b>	<b>\$ (784)</b>

The deferred tax expense (benefit) resulting from temporary differences for the years ended December 31 is as follows:

(Dollar are in thousands)	2012	2011
Organization and start-up cost	\$	\$
Provision for loan losses	534	2,255
Provision for loan commitments		164
Depreciation	(197)	294
Deferred compensation expense	(6)	17
Accrued employee benefits	37	(10)
Nonaccrual loan interest	16	492
Other real estate owned	(28)	(1,038)
Net operating loss carryforward	(2,019)	(2,621)
Goodwill	93	(1,308)
Valuation allowance	4,057	2,723
Other tax adjustment	(34)	(285)
<b>Deferred Income Tax Expense</b>	<b>\$ 2,453</b>	<b>\$ 683</b>

The net deferred tax assets and liabilities resulting from temporary differences as of December 31 are summarized as follows:

(Dollars are in thousands)	2012	2011
<b>Deferred Tax Assets</b>		
Allowance for loan losses	\$ 5,715	\$ 6,249
Deferred compensation	126	120
Accrued employee benefits	49	86
Nonaccrual loan interest	79	95
Other real estate owned	1,551	1,523
Repossessions	47	
Amortization of core deposits	156	151
Amortization of goodwill	888	981
Capitalized interest and repair expense	47	48
Net operating loss carryforward	4,640	2,621
AMT carryforward	252	252
Unrealized loss on securities available for sale		
<b>Total Assets, gross</b>	<b>13,550</b>	<b>12,126</b>
<b>Valuation allowance</b>	<b>(6,780)</b>	<b>(2,723)</b>
<b>Total Assets, net</b>	<b>6,770</b>	<b>9,403</b>

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Deferred Tax Liabilities		
Accelerated depreciation	1,601	1,798
Prepaid expenses	182	202
Deferred loan costs	92	55
Unrealized gain on securities available for sale	209	128
Total Liabilities, gross	2,084	2,183
Net Deferred Tax Asset	\$ 4,686	\$ 7,220

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The following table summarizes the differences between the actual income tax expense and the amounts computed using the federal statutory tax rate of 34%:

(Dollars are in thousands)	2012	2011
Income tax benefit at the applicable federal rate	\$ (1,332)	\$ (3,296)
Permanent differences resulting from:		
Nondeductible expenses	7	8
Tax exempt interest income	(68)	(64)
State income taxes less federal tax effect	31	84
Bank owned life insurance	(133)	(116)
Deferred tax valuation allowance change, net	4,057	2,723
Other adjustments	(157)	(123)
<b>Income Tax Expense (benefit)</b>	<b>\$ 2,405</b>	<b>\$ (784)</b>

Management reviewed the December 31, 2012 deferred tax calculation to determine the need for a valuation allowance. A valuation allowance is provided when it is more likely than not that some portion of the deferred tax asset will not be realized. In management's opinion, based on a three year taxable income projection, tax strategies which would result in potential securities gains and the effects of off-setting deferred tax liabilities, it is more likely than not that all the deferred tax assets, net of the \$6.8 million allowance, would be realizable. Management is required to consider all evidence, both positive and negative in making this determination. Included in deferred tax assets are the tax benefits derived from net operating loss carryforwards totaling \$4.6 million. Management expects to utilize all of these carryforwards prior to expiration.

The Company's tax filings for years ended 2009 through 2012 are currently open to audit under statutes of limitations by the Internal Revenue Service ( IRS ) and the Virginia Department of Taxation. Our tax filings for the years ended 2010 and 2011 are currently under examination by the IRS.

**NOTE 12 RELATED PARTY TRANSACTIONS:**

During the year, officers and directors (and companies controlled by them) were customers of and had loan transactions with the Bank in the normal course of business which amounted to \$4.0 million at December 31, 2012 and \$4.0 million at December 31, 2011. During the year ended December 31, 2012, total principal additions were \$5.7 million and principal payments were \$5.7 million, including renewals and advances on revolving lines of credit. During the year ended December 31, 2011, total principal additions were \$3.4 million and principal payments were \$4.9 million, including renewals and advances on revolving lines of credit. These transactions were made on substantially the same terms as those prevailing for other customers and did not involve any abnormal risk. Total related party deposits held at the Bank were \$9.9 million and \$10.9 million at the end of years 2012 and 2011, respectively.

In December, 2010, the Company borrowed \$250,000 from Director Scott White for one year. The note bore interest at the variable rate of interest equal to the Wall Street Journal prime rate payable at maturity or conversion, was unsecured and was convertible into the Company's common stock under certain conditions. In January, 2011, the Company received an additional \$250,000 loan from Director Lynn Keene on identical terms. The purpose of these borrowings was to provide cash for operating expenses of the Company. On March 16, 2011 Directors Keene and White loaned the Company an additional \$4.95 million which, after receiving regulatory approval, the Company used to retire its indebtedness to the FDIC as receiver for Silverton Bank. The loans had a stated maturity of December 31, 2011 with the same terms as the previous notes. In each case, the Company was obligated to convert the debt into the Company's common stock if, before the stated maturity, the Company conducted an offering of its common stock at the price per share at which it was offered. If the Company did not conduct an offering prior to the stated maturity, the Company had the option, but not the obligation, to convert the debt into shares of its common stock within 30 days of the stated maturity at a price per share to be established by the Company's Board of Directors. On December 21, 2011, with regulatory approval the Company consolidated the earlier loans into a loan in the principal amount of \$2.8 million from Director White and \$2.65 million from Director Keene on the same terms as the previous loans except that the maturity date of the borrowings was extended to June 30, 2012. Prior to their maturity, the maturity of the loans was extended to December 31, 2012 on the same terms. The Company believes this indebtedness was on more favorable terms to the Company than could be obtained from unrelated parties.

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On September 19, 2012, in conjunction with the public offering of its common stock, the Company converted both notes to common stock and Mr. White received 1,959,889 shares and Mr. Keene received 1,854,630 shares. Each director also obtained warrants that are immediately exercisable to purchase common stock over the next five years at a price of \$1.75 per share. Mr. White received 391,977 warrants and Mr. Keene received 370,926 warrants. These conversions were made on the same terms as the public offering as required by the notes.



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During 2010, the branch location in Grundy, Virginia which was part of a condominium in which the Bank and Director Michael McGlothlin owned the only units was condemned by the Virginia Department of Transportation. The value of the Bank's interest in its condemned condominium units was \$892 thousand and the value of Director McGlothlin's interest in his condemned condominium unit was \$455 thousand as appraised by the Virginia Department of Transportation. Subsequently, a new building was constructed on adjacent property with the condemnation proceeds. The Bank's branch in the new building was opened on January 31, 2011 and a portion of the building comparable to his condemned unit was occupied by Director McGlothlin at this time as well. Throughout 2011 additional work was conducted by the contractor. Minor projects remained at the end of 2011 and were completed during 2012. The parties intend the new building to be subject to a condominium agreement, the terms of which had not been finalized at the end of 2012, although they are likely to be substantially similar to the terms of the previous condominium arrangement. Final settlement of the transaction is expected to occur no later than the end of the 1<sup>st</sup> Quarter 2013 on terms the Bank believes are consistent with an arm's length market transaction.

**NOTE 13 INTANGIBLE ASSETS:**

In 2007, the Bank completed the acquisition of two branches in which certain intangible assets were identified related to the value of core deposits. The estimated fair value of the core deposits was determined based on the present value of future cash flow related to those deposits considering the industry standard financial instrument type present value methodology. All-in costs and runoff balances by year were discounted by term specific Federal Home Loan Bank advance rates used as a measure of the best available approximate alternative costs of funds. The estimated economic advantage embedded in the acquired deposits as compared to alternative values is the core deposit intangible.

(Dollars are in thousands)	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
<b>December 31, 2012</b>			
Amortizable core deposit intangibles	\$ 810	\$ 757	\$ 53
<b>December 31, 2011</b>			
Amortizable core deposit intangibles	\$ 810	\$ 687	\$ 123

Amortization expense related to these intangibles is based upon the average economic life of the core deposits. The estimates of expense for the periods are as indicated below using the sum of the years' digits method of amortization.

(Dollars are in thousands)	
<b>Estimated amortization expense</b>	
For the year ended December 31, 2013	\$ 45
For the year ended December 31, 2014	8
<b>Total</b>	<b>\$ 53</b>

Goodwill is tested in accordance with ASC 350 at least annually, as of November 30, to determine if there is any impairment. Based on the results of testing conducted as of November 30, 2011, goodwill was determined to not be impaired. However, due to a trade in the Company's common stock that occurred after year end 2011 and other factors, Management determined that there was indication that goodwill may be impaired. Accordingly, goodwill was also tested for impairment as of December 31, 2011. As a result of this test, it was determined that an impairment charge of \$4.1 million was necessary, which resulted in a complete write-off of the goodwill as of December 31, 2011.

**Table of Contents****NOTE 14 RETIREMENT PLANS:**

The Company has established a qualified defined contribution plan that covers all full time employees. Effective January 1, 2012 the qualified defined contribution plan was modified where the Company matched employee contributions up to a maximum of 3% of their salary for 2012. For 2011, the Company matched employee contributions up to a maximum of 5% of their salary. The Company contributed \$248 thousand and \$504 thousand to the defined contribution plan for 2012 and 2011, respectively.

In addition, in 2002, the Bank established a salary continuation plan for key executives, which is funded by single premium life insurance policies. Expenses related to the plan were \$26 thousand and \$55 thousand for 2012 and 2011, respectively.

**NOTE 15 STOCK OPTION PLAN:**

New Peoples' Stock Option Plan (the Plan) was adopted on September 27, 2001. The purpose of the Plan is to reward employees and directors for services rendered and investment risks undertaken to date and to promote the success of the Company by providing incentives to employees and directors that will promote the identification of their personal interest with the long-term financial success of the Company and with growth in shareholder value. The Plan provides that options for up to 1,287,000 shares of the Company's common stock may be issued to employees and directors. The exercise price may not be less than 100% of the fair market value of the shares on the award date. Each award becomes exercisable in the event of a change in control of the Company. All options are subject to exercise or forfeiture if the Company's capital falls below minimum requirements, as determined by its primary state or federal regulator. The Plan expired on May 31, 2011. All options granted and outstanding are fully vested. The Company did not grant any options in 2012 and 2011. No stock options were exercised in 2012 and 2011.

Information about stock options outstanding at December 31, 2012 follows:

Exercise Price	Number Outstanding And Exercisable	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
\$ 6.99	54,567	1.01 years	
\$ 9.44	78,521	1.92 years	
\$ 11.54	238,778	2.97 years	
Totals	371,866	2.46 years	\$ 10.43

A summary of the status of the Company's stock option plan is presented below:

	2012		2011		2010	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding and exercisable, Beginning of year	461,773	\$ 10.08	771,344	\$ 8.81	920,256	\$ 8.77
Exercised					(1,141)	6.88
Forfeited	(46,116)	10.18	(154,382)	8.58	(147,771)	8.58
Expired	(43,791)	6.99	(155,189)	5.25		
Outstanding and exercisable, End of year	371,866	\$ 10.43	461,773	\$ 10.08	771,344	\$ 8.81

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**NOTE 16 DIVIDEND LIMITATIONS ON SUBSIDIARY BANK:**

The principal source of funds of the Company is dividends paid by the Bank. The Federal Reserve Act restricts the amount of dividends the Bank may pay. Approval by the Board of Governors of the Federal Reserve System is required if the dividends declared by a state member bank, in any year, exceed the sum of (1) net income of the current year and (2) income net of dividends for the preceding two years. In October 2009, a restriction prohibiting the payment of dividends from the Bank to the Company was imposed by the Federal Reserve Bank of Richmond. Therefore, no dividends will be available to the Company from the Bank until such restriction is removed.

**NOTE 17 LEASING ACTIVITIES:**

The Company's leasing activities consist of the leasing of land and buildings under agreements in which the Bank is lessee. These leases have been classified as operating leases.

Future minimum rental payments, required under non-cancelable operating leases that have initial or remaining non-cancelable lease terms in excess of one year as of December 31, 2012 is approximately \$6 thousand per year for the next five years.

Rental commitments of less than one year are not included. Rentals charged to operations under operating leases were \$12 thousand and \$13 thousand for the years ended 2012 and 2011, respectively.

**NOTE 18 AVAILABLE LINES OF CREDIT AND FEDERAL HOME LOAN BANK ADVANCES:**

The Bank has the ability to borrow up to an additional \$41.1 million from the Federal Home Loan Bank under a line of credit which is secured by a blanket lien on residential real estate loans. The Bank had no overnight borrowings subject to daily rate changes from the Federal Home Loan Bank at December 31, 2012 or 2011. All other borrowings are at fixed rates.

The Bank had \$6.6 million in term borrowings with the Federal Home Loan Bank at December 31, 2012 and \$18.0 million at December 31, 2011. During 2012 we incurred a \$90 thousand prepayment penalty due to the early payoff of the two convertible notes totaling \$10.2 million at December 31, 2011 with a weighted average interest rate of 4.04% and a quarterly Bermudan call feature. Two additional borrowings totaling \$6.6 million and \$7.8 million were outstanding at December 31, 2012 and 2011 respectively. These borrowings were obtained in 2008 to fund various real estate loans. These borrowings have fixed rates with an average weighted interest rate of 4.07%, with monthly principal and interest through 2018.

A letter of credit for \$7.0 million was issued in 2008 and a letter of credit for \$3.0 million was issued in 2010 to the Treasury Board of Virginia for collateral on public funds. No draws on the letters of credit have been issued. The letters of credit are considered draws on our Federal Home Loan Bank line of credit which is secured by a blanket lien on residential real estate loans.

**NOTE 19 LEGAL CONTINGENCIES:**

Various legal claims arise from time to time in the normal course of business which, in the opinion of management, will have no material effect on the Company's consolidated financial statements.

**Table of Contents****NOTE 20 FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK:**

In the normal course of business, the Bank has outstanding commitments and contingent liabilities, such as commitments to extend credit and standby letters of credit, which are not included in the accompanying consolidated financial statements. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual or notional amount of those instruments. The Bank uses the same credit policies in making such commitments as it does for instruments that are included in the balance sheet.

Financial instruments whose contract amount represents credit risk were as follows:

(Dollars are in thousands)	2012	2011
Commitments to extend credit	\$ 27,887	\$ 29,004
Standby letters of credit	2,721	3,049

Commitments to extend credit are agreements to lend to a customer at either a fixed or variable interest rate as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Standby letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank's policy for obtaining collateral, and the nature of such collateral, is essentially the same as that involved in making commitments to extend credit.

**NOTE 21 TRUST PREFERRED SECURITIES AND DEFERRAL OF INTEREST PAYMENTS:**

On September 27, 2006, the Company completed the issuance of \$5.2 million in floating rate trust preferred securities offered by its wholly owned subsidiary, NPB Capital Trust 2. The proceeds of the funds were used for general corporate purposes, which include capital management for affiliates and the acquisition of two branch banks. The securities have a floating rate of 3 month LIBOR plus 177 basis points, which resets quarterly, with a current rate at December 31, 2012 of 2.11%.

On July 7, 2004, the Company completed the issuance of \$11.3 million in floating rate trust preferred securities offered by its wholly owned subsidiary, NPB Capital Trust I. The proceeds of the funds were used for general corporate purposes which included capital management for affiliates, retirement of indebtedness and other investments. The securities have a floating rate of 3 month LIBOR plus 260 basis points, which resets quarterly, with a current rate at December 31, 2012 of 2.94%.

Under the terms of the subordinated debt transactions, the securities mature in 30 years and are redeemable, in whole or in part, without penalty, at the option of the Company after five years. Due to the ability to defer interest and principal payments for 60 months without being considered in default, the regulatory agencies consider the trust preferred securities as Tier 1 capital up to certain limits.

In October 2009, a restriction to pay dividends from the Bank to the Company was issued by the Federal Reserve Bank of Richmond. As a result, dividends on trust preferred securities issued by the Company shall be deferred until such restriction is removed. This deferral is for a period of 60 months, and could potentially continue until the 1<sup>st</sup> quarter of 2015. Dividends in arrears on the trust preferred securities were \$1.5 million and \$993 thousand as of December 31, 2012 and 2011, respectively and are included in accrued interest payable on the balance sheets.

**Table of Contents****NOTE 22 CAPITAL:****Capital Requirements and Ratios**

The Company and the Bank are subject to various capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and, possibly, additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Management believes that, as of December 31, 2012, the Company and the Bank meet all capital adequacy requirements to which they are subject.

As of December 31, 2012 the Bank was well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Company's and Bank's category.

The Company's and the Bank's actual capital amounts and ratios are presented in the table as of December 31, 2012 and 2011, respectively.

(Dollars are in thousands)	Actual		Minimum Capital Requirement		Minimum to Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>December 31, 2012:</b>						
Total Capital to Risk Weighted Assets						
The Company	\$ 57,894	13.51%	34,291	8%	\$ N/A	N/A
The Bank	55,315	12.88%	34,353	8%	42,941	10%
Tier 1 Capital Risk Weighted Assets:						
The Company	49,530	11.56%	17,146	4%	N/A	N/A
The Bank	49,806	11.60%	17,176	4%	25,765	6%
Tier 1 Capital to Average Assets:						
The Company	49,530	7.05%	28,092	4%	N/A	N/A
The Bank	49,806	7.08%	28,120	4%	35,150	5%
<b>December 31, 2011:</b>						
Total Capital to Risk Weighted Assets						
The Company	\$ 45,856	9.15%	40,104	8%	\$ N/A	N/A
The Bank	53,070	10.56%	40,189	8%	50,236	10%
Tier 1 Capital Risk Weighted Assets:						
The Company	32,941	6.57%	20,052	4%	N/A	N/A
The Bank	46,641	9.28%	20,095	4%	30,142	6%
Tier 1 Capital to Average Assets:						
The Company	33,461	4.23%	31,658	4%	N/A	N/A
The Bank	46,641	5.99%	31,160	4%	38,950	5%

**Table of Contents****Conversion of Notes to Common Stock and Warrants**

In December, 2010, the Company borrowed \$250,000 from Director Scott White for one year. The note bore interest at the variable rate of interest equal to the Wall Street Journal prime rate payable at maturity or conversion, was unsecured and was convertible into the Company's common stock under certain conditions. In January, 2011, the Company received an additional \$250,000 loan from Director Lynn Keene on identical terms. The purpose of these borrowings was to provide cash for operating expenses of the Company. On March 16, 2011 Directors Keene and White loaned the Company an additional \$4.95 million which, after receiving regulatory approval, the Company used to retire its indebtedness to the FDIC as receiver for Silverton Bank. The loans had a stated maturity of December 31, 2011 with the same terms as the previous notes. In each case, the Company was obligated to convert the debt into the Company's common stock if, before the stated maturity, the Company conducted an offering of its common stock at the price per share at which it was offered. If the Company did not conduct an offering prior to the stated maturity, the Company had the option, but not the obligation, to convert the debt into shares of its common stock within 30 days of the stated maturity at a price per share to be established by the Company's Board of Directors. On December 21, 2011, with regulatory approval the Company consolidated the earlier loans into a loan in the principal amount of \$2.8 million from Director White and \$2.65 million from Director Keene on the same terms as the previous loans except that the maturity date of the borrowings was extended to June 30, 2012. Prior to their maturity, the maturity of the loans was extended to December 31, 2012 on the same terms. The Company believes this indebtedness was on more favorable terms to the Company than could be obtained from unrelated parties.

On September 19, 2012, in conjunction with the public offering of its common stock, the Company converted both notes to common stock and Mr. White received 1,959,889 shares and Mr. Keene received 1,854,630 shares. Each director also obtained warrants that are immediately exercisable to purchase common stock over the next five years at a price of \$1.75 per share. Mr. White received 391,977 warrants and Mr. Keene received 370,926 warrants. These conversions were made on the same terms as the public offering as required by the notes. All warrants issued are detachable from the common stock and are therefore considered a separate security. Accordingly, accounting standards require that the proceeds of the offering be allocated between common stock and the warrants based on fair value. The value of the warrants were determined using the Black-Scholes Option Pricing Model. The assumptions used in the model were a risk free rate of return of .70%, an expected term of five years, a dividend rate of zero, and volatility of 88%.

As a result of this noncash transaction, the Company recorded a \$5.7 million increase to stockholders' equity and reduced other borrowings by \$5.45 million and accrued interest payable by \$272 thousand. The \$5.7 million increase to stockholders' equity was allocated by an increase of \$7.6 million to common stock, \$663 thousand allocated to the common stock warrants, and a decrease of \$2.6 million to additional paid in capital.

**Issuance of Common Stock and Warrants**

On December 20, 2012 the Company successfully completed a public offering of its common stock for \$1.50 per share. Under the terms of the offering, for every five shares purchased, the buyer received a warrant to purchase one share of common stock. As a result 8,040,838 shares of common stock and 1,607,997 warrants were issued. The warrants are immediately exercisable to purchase common stock over the next five years at a price of \$1.75 per share. All warrants issued are detachable from the common stock and are therefore considered a separate security. Accordingly, accounting standards require that the proceeds of the offering be allocated between common stock and the warrants based on fair value. The value of the warrants were determined using the Black-Scholes Option Pricing Model. The assumptions used in the model were a risk free rate of return of .72%, an expected term of five years, a dividend rate of zero, and volatility of 88%. The \$11.4 million increase to stockholders' equity was allocated by an increase of \$16.1 million to common stock, \$1.4 million allocated to the common stock warrants, and a decrease of \$6.0 million to additional paid in capital, which includes \$624 thousand in expenses related to the public offering.

**Common Stock Warrants**

As summary of common stock warrants outstanding at December 31, 2012 follows:

Expiration Date	Exercise Price	Number Outstanding And Exercisable	Weighted Average Remaining Contractual Life
September 19, 2017	\$ 1.75	762,903	4.72 years
December 20, 2017	\$ 1.75	1,607,997	4.97 years

Totals	2,370,900	4.89 years
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**Table of Contents****NOTE 23 FAIR VALUES:**

ASC 820, Fair Value Measurements and Disclosures provides a framework for measuring fair value under generally accepted accounting principles and requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available for sale investment securities) or on a nonrecurring basis (for example, impaired loans and other real estate acquired through foreclosure).

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Fair Value Measurements and Disclosures also establishes fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an exchange market, as well as U. S. Treasury, other U. S. Government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2: Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes certain derivative contracts and impaired loans.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. For example, this category generally includes certain private equity investments, retained residual interests in securitizations, residential mortgage servicing rights, and highly structured or long-term derivative contracts.

*Investment Securities Available for Sale* Investment securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices. The Company's available for sale securities, totaling \$49.6 million and \$32.4 million at December 31, 2012 and 2011, respectively, are the only assets whose fair values are measured on a recurring basis using Level 2 inputs from an independent pricing service.

*Loans* The Company does not record loans at fair value on a recurring basis. The Company is predominantly an asset based lender with real estate serving as collateral on a substantial majority of loans. From time to time a loan is considered impaired and an allowance for loan losses is established. Loans which are deemed to be impaired and require a reserve are primarily valued on a non-recurring basis at the fair values of the underlying real estate collateral. Such fair values are obtained using independent appraisals, which management evaluates and determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, or an appraised value does not include estimated costs of disposition and management must make an estimate, the Company records the impaired loan as nonrecurring Level 3. The aggregate carrying amount of impaired loans carried at fair value were \$59.3 million and \$85.8 million at December 31, 2012 and 2011, respectively.

*Foreclosed Assets* Foreclosed assets are adjusted to fair value upon transfer of the loans to foreclosed assets. Foreclosed assets are carried at the lower of the carrying value or fair value. Fair value is based upon independent observable market prices or appraised values of the collateral with a third party estimate of disposition costs, which the Company considers to be level 2 inputs. When the appraised value is not available, management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, or an appraised value does not include estimated costs of disposition and management must make an estimate, the Company records the foreclosed asset as nonrecurring Level 3. The aggregate carrying amounts of foreclosed assets were \$13.9 million and \$15.1 million at December 31, 2012 and 2011, respectively.



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Assets and liabilities measured at fair value are as follows as of December 31, 2012 (for purpose of this table the impaired loans are shown net of the related allowance):

	Quoted market price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
(Dollars are in thousands)			
(On a recurring basis)			
Available for sale investments			
U.S. Government Agencies	\$	\$ 23,637	\$
Mortgage backed securities		25,978	
(On a non-recurring basis)			
Other real estate owned			13,869
Impaired loans:			
Real estate secured:			
Commercial			30,688
Construction and land development			4,375
Residential 1-4 family			9,561
Multifamily			2,500
Farmland			9,442
Commercial			2,501
Agriculture			154
Consumer installment loans			109
All other loans			
Total	\$	\$ 49,615	\$ 73,199

Assets and liabilities measured at fair value are as follows as of December 31, 2011 (for purpose of this table the impaired loans are shown net of the related allowance):

	Quoted market price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
(Dollars are in thousands)			
(On a recurring basis)			
Available for sale investments			
U.S. Government Agencies	\$	\$ 21,633	\$
Taxable municipals		1,552	
Tax-exempt municipals		1,054	
Mortgage backed securities		8,195	
(On a non-recurring basis)			
Other real estate owned			15,092
Impaired loans:			
Real estate secured:			
Commercial			43,321
Construction and land development			8,769
Residential 1-4 family			13,642
Multifamily			613
Farmland			13,951
Commercial			4,737

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Agriculture				714
Consumer installment loans				28
All other loans				
Total		\$	\$ 32,434	\$ 100,867

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

(Dollars in thousands)	Fair Value at December 31, 2012	Valuation Technique	Significant Unobservable Inputs	Significant Unobservable Input Value
Impaired Loans	\$ 59,330	Appraised Value/Discounted Cash Flows/Market Value of Note	Appraisals and/or sales of comparable properties/Independent quotes	n/a
Other Real Estate Owned	\$ 13,869	Appraised Value/Comparable Sales/Other Estimates from Independent Sources	Appraisal and/or sales of comparable properties/Independent quotes/bids	n/a

**Fair Value of Financial Instruments**

Fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practical to estimate the value is based upon the characteristics of the instruments and relevant market information. Financial instruments include cash, evidence of ownership in an entity, or contracts that convey or impose on an entity that contractual right or obligation to either receive or deliver cash for another financial instrument.

The following summary presents the methodologies and assumptions used to estimate the fair value of the Company's financial instruments presented below. The information used to determine fair value is highly subjective and judgmental in nature and, therefore, the results may not be precise. Subjective factors include, among other things, estimates of cash flows, risk characteristics, credit quality, and interest rates, all of which are subject to change. Since the fair value is estimated as of the balance sheet date, the amounts that will actually be realized or paid upon settlement or maturity on these various instruments could be significantly different.

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Company's financial instruments as of December 31, 2012 and 2011. This table excludes financial instruments for which the carrying amount approximates fair value. The carrying value of cash and due from banks, federal funds sold, interest-bearing deposits, deposits with no stated maturities, trust preferred securities and accrued interest approximates fair value. The remaining financial instruments were valued based on the present value of estimated future cash flows, discounted at various rates in effect for similar instruments during the months of December 2012 and 2011.

(Dollars are in thousands)		Carrying Amount	Fair Value	Fair Value Measurements		
				Quoted market price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<b>December 31, 2012</b>						
Financial Instruments	Assets					
	Net Loans	\$ 505,553	\$ 507,358	\$	\$ 448,028	\$ 59,330
Financial Instruments	Liabilities					
	Time Deposits	372,473	375,784		375,784	
	FHLB Advances	6,558	6,558		6,558	
<b>December 31, 2011</b>						
Financial Instruments	Assets					
	Net Loans	\$ 579,436	\$ 588,888	\$	\$ 503,113	\$ 85,775
Financial Instruments	Liabilities					

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Time Deposits	445,658	451,312	451,312
FHLB Advances	17,983	17,756	17,756

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**NOTE 24 RECENT ACCOUNTING DEVELOPMENTS:**

The following is a summary of recent authoritative announcements:

In April 2011 the FASB issued ASU 2011-02 to assist creditors with their determination of when a restructuring is a Troubled Debt Restructuring ( TDR ). The determination is based on whether the restructuring constitutes a concession and whether the debtor is experiencing financial difficulties as both events must be present. The new guidance was effective for the Company beginning January 1, 2012 and did not have a material effect on the Company s TDR determinations.

In April 2011, the criteria used to determine effective control of transferred assets in the Transfers and Servicing topic of the ASC was amended by Accounting Standards Update 2011-03. The requirement for the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms and the collateral maintenance implementation guidance related to that criterion were removed from the assessment of effective control. The other criteria to assess effective control were not changed. The amendments are effective for the Company on January 1, 2012 and had no effect on the financial statements.

ASU 2011-04 was issued in May 2011 to amend the Fair Value Measurement topic of the ASC by clarifying the application of existing fair value measurement and disclosure requirements and by changing particular principles or requirements for measuring fair value or for disclosing information about fair value measurements. The amendments were effective for the Company beginning January 1, 2012 and had no effect on the financial statements except for expanded disclosures.

The Comprehensive Income topic of the ASC was amended in June 2011. The amendment eliminates the option to present other comprehensive income as a part of the statement of changes in stockholders equity and requires consecutive presentation of the statement of net income and other comprehensive income. The amendments were applicable to the Company on January 1, 2012 and have been applied retrospectively. The amendment had no material effect on the financial statements.

The FASB amended the Comprehensive Income topic of the ASC in February 2013. The amendment addresses reporting of amounts reclassified out of accumulated other comprehensive income. Specifically, the amendment does not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendment does require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, in certain circumstances an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. The amendment will be effective for the Company on a prospective basis for reporting periods beginning after December 15, 2012. Early adoption is permitted. The Company does not expect this amendment to have a material effect on its financial statements.

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

**Table of Contents****NOTE 25 PARENT CORPORATION ONLY FINANCIAL STATEMENTS:  
CONDENSED BALANCE SHEETS****AS OF DECEMBER 31, 2012 AND 2011**

(Dollars in Thousands)

	2012	2011
<b>ASSETS</b>		
Due from banks	\$ 4,589	\$ 211
Investment in subsidiaries	53,166	51,854
Other assets	667	2,224
<b>Total Assets</b>	<b>\$ 58,422</b>	<b>\$ 54,289</b>
<b>LIABILITIES</b>		
Accrued interest payable	\$ 1,484	\$ 1,138
Accrued expenses and other liabilities	576	2,332
Other borrowed money		5,450
Trust preferred securities	16,496	16,496
<b>Total Liabilities</b>	<b>18,556</b>	<b>25,416</b>
<b>STOCKHOLDERS EQUITY</b>		
Common stock \$2.00 par value, 50,000,000 shares authorized; 21,865,535 and 10,010,178 shares issued and outstanding at December 31, 2012 and 2011, respectively	43,731	20,020
Common stock warrants	2,056	
Additional paid capital	13,081	21,689
Retained deficit	(19,409)	(13,085)
Accumulated other comprehensive income	407	249
<b>Total Stockholders Equity</b>	<b>39,866</b>	<b>28,873</b>
<b>Total Liabilities and Stockholders Equity</b>	<b>\$ 58,422</b>	<b>\$ 54,289</b>

**CONDENSED STATEMENTS OF OPERATIONS****FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

(Dollars in Thousands)	2012	2011
<b>Income</b>		
Miscellaneous income	\$ 15	\$ 14
Undistributed loss of subsidiaries	(5,847)	(7,375)
<b>Total loss</b>	<b>(5,832)</b>	<b>(7,361)</b>
<b>Expenses</b>		
Other borrowed money interest expense	128	194
Trust preferred securities interest expense	490	436

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Legal fees	61	51
Accounting fees	155	68
Other operating expenses	63	(150)
<b>Total Expenses</b>	<b>897</b>	<b>599</b>
<b>Loss before Income Taxes</b>	<b>(6,729)</b>	<b>(7,960)</b>
Income Tax Expense (Benefit)	(405)	950
<b>Net Loss</b>	<b>\$ (6,324)</b>	<b>\$ (8,910)</b>

**Table of Contents****CONDENSED STATEMENTS OF CASH FLOWS****FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

(Dollars and Shares in Thousands)	2012	2011
<b>Cash Flows From Operating Activities</b>		
Net Loss	\$ (6,324)	\$ (8,910)
Adjustments to reconcile net income to net cash provided by (used) in operating activities:		
Income of subsidiaries	5,847	7,375
Net change in:		
Other assets	1,556	1,247
Other liabilities	(1,138)	(2)
Net Cash Used in Operating Activities	(59)	(290)
<b>Cash Flows From Investing Activities</b>		
Investment in subsidiary	(7,000)	
Net Cash Used in Investing Activities	(7,000)	
<b>Cash Flows From Financing Activities</b>		
Issuance of common stock and common stock warrants	11,437	
Proceeds from (repayments on) line of credit		(4,900)
Proceeds from other borrowings		5,200
Net Cash Provided by Financing Activities	11,437	300
<b>Net Increase in Cash and Cash Equivalents</b>	<b>4,378</b>	<b>10</b>
Cash and Cash Equivalents, Beginning of year	211	201
<b>Cash and Cash Equivalents, End of Year</b>	<b>\$ 4,589</b>	<b>\$ 211</b>
Supplemental Disclosure of Cash Paid During the Year for:		
Interest	\$	\$ 50
Taxes	\$	\$
Supplemental Disclosure of Non Cash Transactions:		
Conversion of Director notes in other borrowings to common stock	\$ 5,450	\$
Conversion of accrued interest payable on Director notes to common stock	\$ 272	\$
Common stock issued as a result of the conversion of Director notes	\$ 5,722	\$



**Table of Contents****NOTE 26 SELECTED QUARTERLY INFORMATION (UNAUDITED)**

(Dollars in thousands except per share data)	<b>2012 QUARTERS</b>			
	Fourth	Third	Second	First
<b>Income statement</b>				
Net interest income	\$ 6,732	\$ 6,763	\$ 6,653	\$ 7,125
Noninterest income	1,140	1,355	1,634	1,467
Provision for credit losses	707	967	1,176	1,950
Noninterest expense	6,911	7,838	8,252	8,987
Net income (loss)	212	(1,463)	(2,538)	(2,535)
Earnings (loss) per share, basic	0.07	(0.14)	(0.25)	(0.25)
Earnings (loss) per share, fully diluted	0.07	(0.14)	(0.25)	(0.25)
<b>Period end balance sheet</b>				
Total loans and leases	\$ 522,363	\$ 538,992	\$ 554,103	\$ 573,752
Total assets	719,015	708,217	725,615	768,447
Total deposits	652,850	653,217	669,337	699,085
Total shareholders' equity	39,866	28,118	23,718	26,170

(Dollars in thousands except per share data)	<b>2011 Quarters</b>			
	Fourth	Third	Second	First
<b>Income statement</b>				
Net interest income	\$ 8,162	\$ 7,742	\$ 8,089	\$ 8,170
Noninterest income	1,615	1,364	1,234	1,311
Provision for credit losses	1,701	2,801	2,312	1,145
Noninterest expense	13,079	9,113	9,617	7,613
Net income (loss)	(5,952)	(1,832)	(1,675)	549
Earnings (loss) per share, basic	(0.59)	(0.18)	(0.17)	0.05
Earnings (loss) per share, fully diluted	(0.59)	(0.18)	(0.17)	0.05
<b>Period end balance sheet</b>				
Total loans and leases	\$ 597,816	\$ 629,610	\$ 664,003	\$ 683,025
Total assets	780,384	810,355	821,107	864,665
Total deposits	708,315	731,989	741,153	782,411
Total shareholders' equity	28,873	34,686	36,480	38,086

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### **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

Not applicable.

### **Item 9A. Controls and Procedures**

#### **Management's Report on Internal Control over Financial Reporting**

Management is responsible for establishing and maintaining adequate internal control over financial reporting of New Peoples Bankshares, Inc. New Peoples' internal control system was designed to provide reasonable assurance to management and the Board of Directors regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting practices.

All internal control systems, no matter how well designed, have inherent limitations. Because of these inherent limitations, internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation and presentation, and may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of New Peoples' internal control over financial reporting as of December 31, 2012. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control - Integrated Framework. Based on this assessment management concluded that the internal control over financial reporting was effective as of December 31, 2012.

#### **Changes in Internal Control Over Financial Reporting**

There have been no changes in our internal control over financial reporting during the last fiscal quarter that materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

#### **Disclosure Controls and Procedures**

We maintain a system of disclosure controls and procedures that is designed to ensure that material information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were operating effectively as of December 31, 2012.

### **Item 9B. Other Information**

None.

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**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance**

The information contained under the captions Election of Directors, Executive Officers Who Are Not Directors, Corporate Governance and Section 16(a) Beneficial Ownership Reporting Compliance in the 2013 Proxy Statement that is required to be disclosed in this Item 10 is incorporated herein by reference.

**Item 11. Executive Compensation**

The information contained under the captions Director Compensation and Executive Compensation and Related Party Transactions in the 2013 Proxy Statement that is required to be disclosed in this Item 11 is incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information contained under the captions Security Ownership of Management and Security Ownership of Certain Beneficial Owners in the 2013 Proxy Statement that is required to be disclosed in this Item 12 is incorporated herein by reference.

**Item 13. Certain Relationships, Related Transactions and Director Independence**

The information contained under the caption Executive Compensation and Related Party Transactions and Corporate Governance in the 2013 Proxy Statement that is required to be disclosed in this Item 13 is incorporated herein by reference.

**Item 14. Principal Accountant Fees and Services**

The information contained under the caption Audit Information in the 2013 Proxy Statement that is required to be disclosed in this Item 14 is incorporated herein by reference.

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**Item 15. Exhibits and Financial Statement Schedules**

- (a)(1) The response to this portion of Item 15 is included in Item 8 above.
- (a)(2) The response to this portion of Item 15 is included in Item 8 above.
- (a)(3) The following exhibits are filed as part of this Form 10-K, and this list includes the exhibit index::

Exhibit	
Number	
3.1	Amended Articles of Incorporation of New Peoples Bankshares, Inc. (incorporated by reference to Exhibit 3.1 to Form 10-Q for the quarterly period ended June 30, 2008 filed on August 11, 2008).
3.2	Bylaws of Registrant (incorporated by reference to Exhibit 3.1 to Form 8-K filed April 15, 2004).
4.1	Specimen Common Stock Certificate of New Peoples Bankshares, Inc. (incorporated by reference to Exhibit 4.1 to Form 10-Q for the quarterly period ended June 30, 2012 filed on August 14, 2012).
4.2	Form of Warrant to Purchase Shares of Common Stock (incorporated by reference to Exhibit 4.2 to Form 10-Q for the quarterly period ended June 30, 2012 filed on August 14, 2012).
4.3	Form of Rights Certificate (incorporated by reference to Exhibit 4.3 to Form 10-Q for the quarterly period ended June 30, 2012 filed on August 14, 2012).
10.1*	New Peoples Bank, Inc. 2001 Stock Option Plan (incorporated by reference to Exhibit 10.1 to Annual Report on Form 10-KSB for the fiscal year ended December 31, 2001).
10.2*	Form of Non-Employee Director Non-Qualified Stock Option Agreement (incorporated by reference to Exhibit 10.2 to Form 8-K filed November 30, 2004)
10.3*	Form of Incentive Stock Option Agreement (incorporated by reference to Exhibit 10.3 to Form 8-K filed November 30, 2004).
10.4*	Salary Continuation Agreement dated December 18, 2002 between New Peoples Bank, Inc. and Frank Sexton, Jr. (incorporated by reference to Exhibit 10.6 to Annual Report on Form 10-K for the fiscal year ended December 31, 2004).
10.5*	First Amendment dated June 30, 2003 to Salary Continuation Agreement between New Peoples Bank, Inc. and Frank Sexton, Jr. (incorporated by reference to Exhibit 10.7 to Annual Report on Form 10-K for the fiscal year ended December 31, 2004).
10.6*	Letter Agreement, dated as of June 29, 2009, between the Company and Kenneth D. Hart (incorporated by reference to Exhibit 10.1 to Quarterly Report on Form 10-Q for the quarter ended June 30, 2009).
10.7	Written Agreement, effective August 4, 2010, by and among New Peoples Bankshares, Inc., New Peoples Bank, Inc., the Federal Reserve Bank of Richmond and the State Corporation Commission Bureau of Financial Institutions (incorporated by reference to Exhibit 10.1 to Form 8-K filed August 6, 2010).
10.8	Engagement Letters of Scott & Stringfellow, LLC (incorporated by reference to Exhibit 10.8 to Form 10-Q for the quarterly period ended June 30, 2012 filed on August 14, 2012).
10.9	Convertible Note Payable, B. Scott White, dated June 27, 2012 (incorporated by reference to Exhibit 10.1 to Form 8-K filed June 29, 2012).
10.10	Convertible Note Payable, Harold Lynn Keene, dated June 27, 2012 (incorporated by reference to Exhibit 10.2 to Form 8-K filed June 29, 2012).
14	Code of Ethics (incorporated by reference to Exhibit 14 to Annual Report on Form 10-K for the fiscal year ended December 31, 2003).
21	Subsidiaries of the Registrant.
23	Consent of Elliott Davis, LLC.
24	Powers of Attorney (contained on signature page).

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- 31.1 Certification by Chief Executive Officer pursuant to Rule 13a-14(a).
- 31.2 Certification by Chief Financial Officer pursuant to Rule 13a-14(a).
- 32 Certification by Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350.
- 101 The following materials for the Company's 10-K Report for the year ended December 31, 2012, formatted in XBRL: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Comprehensive Income (Loss), (iv) the Consolidated Statements of Changes in Stockholders' Equity, (v) the Consolidated Statements of Cash Flows, and (vi) the Notes to the Consolidated Financial Statements, tagged as blocks of text <sup>(1)</sup>

\* Denotes management contract.

<sup>(1)</sup> Furnished, not filed.

(b) See Item 15(a)(3) above.

(c) See Items 15(a)(1) and (2) above.

**Table of Contents****SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**NEW PEOPLES BANKSHARES, INC.**

By: /s/ JONATHAN H. MULLINS  
Jonathan H. Mullins  
President and Chief Executive Officer  
Date: March 19, 2013

By: /s/ C. TODD ASBURY  
C. Todd Asbury  
Executive Vice President and Chief Financial Officer  
Date: March 19, 2013

**POWER OF ATTORNEY**

Each of the undersigned hereby appoints Jonathan H. Mullins and C. Todd Asbury, and each of them, as attorneys and agents for the undersigned, with full power of substitution, in his name and on his behalf as a director of New Peoples Bankshares, Inc. (the Registrant), to act and to execute any and all instruments as such attorneys or attorney deem necessary or advisable to enable the Registrant to comply with the Securities Exchange Act of 1934, and any rules, regulations, policies or requirements of the Securities and Exchange Commission (the Commission) in respect thereof, in connection with the preparation and filing with the Commission of the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2012 (the Report), and any and all amendments to such Report, together with such other supplements, statements, instruments and documents as such attorneys or attorney deem necessary or appropriate.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated.

Signature	Capacity	Date
/s/ JONATHAN H. MULLINS Jonathan H. Mullins	President, Chief Executive Officer and Director (Principal Executive Officer)	March 19, 2013
/s/ C. TODD ASBURY C. Todd Asbury	Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 19, 2013
/s/ TIM BALL Tim Ball	Director	March 19, 2013
/s/ JOE CARTER Joe Carter	Director	March 19, 2013
/s/ JOHN D. COX	Chairman, Director	March 19, 2013

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John D. Cox

/s/ CHARLES H. GENT

Director

March 19, 2013

Charles H. Gent

/s/ EUGENE HEARL

Director

March 19, 2013

Eugene Hearl

/s/ HAROLD LYNN KEENE

Director

March 19, 2013

Harold Lynn Keene

/s/ MICHAEL G. MCGLOTHLIN

Director

March 19, 2013

Michael G. McGlothlin

/s/ FRED MEADE

Director

March 19, 2013

Fred Meade

/s/ B. SCOTT WHITE

Director

March 19, 2013

B. Scott White