



Uwharrie

CAPITAL CORP

Third Quarter Report – September 30, 2013

www.Uwharrie.com

November 22, 2013

Dear Shareholder:

The third quarter of 2013 was an active quarter for your Company. We completed our name change and the legal conversion of our three bank charters on September 1, 2013. This was another milestone in your management's efforts to create a more efficient operating structure in an increasingly complex bank regulatory environment. Bank operating costs are on the rise as the industry takes steps to comply with the 2,319 page Dodd-Frank Wall Street Reform and Consumer Protection Act. The banking industry business model, as a result, is changing and is requiring banks of all sizes to look at how we deliver our services and manage the risk associated with financial products. Thus far, the re-design of our operating structure has resulted in non-interest expense for the third quarter 2013 improving \$592 thousand over the same period 2012. Management anticipates further improvement in operating expenses as we begin to realize the efficiencies of our charter consolidation going forward.

The improvement year-to-date, however, was not enough to offset the \$1.26 million decline in net interest margin that we have experienced over last year. The slow economic recovery has squeezed net interest margins of all banks as more funds are invested in low-yielding assets than loans. Our loans outstanding are down \$27.2 million compared to third quarter 2012 and \$9.1 million from the end of second quarter 2013. As these loans paid down, our deposit base and market share continued to grow, resulting in surplus funds. Our overnight Federal funds sold have grown to \$49.7 million as of September 30, 2013. Your company would love to give these loans a home in the form of local loans to businesses and individuals in our area, so please let our lending officers know of any good loan opportunities that you may know of in the community. If you have loans at another institution, please give us the opportunity to speak with you about moving those accommodations to your bank, which will benefit you as a stockholder.

Many community banks are investing in longer term bonds in an effort to marginally improve spread and earnings. We think this action is shortsighted in light of the fact that we are at the bottom of a historically low interest-rate cycle. Investing in longer-term bonds at this point will result in "paper" bond losses and a loss of capital as interest rates rise. Forgoing current income by staying short in our investment portfolio is better risk management and represents greater value to our shareholders in this uncertain environment. We continue to explore strategies that allow us to invest our surplus funds without putting our capital at undue risk.

To further complicate matters, we witnessed a slowdown in the refinance boom that has provided us significant levels of fee income from our home mortgage program. Mortgage operation income was strong in the first half of 2013, but not at the level of 2012. Year-to-date 2012 mortgage income was \$2.6 million compared to \$1.8 million year-to-date 2013. Other non-interest income from Strategic Investment Advisors was up slightly by \$20 thousand over last year, while deposit service charges declined by \$113 thousand. In these difficult economic times, less activity in bank accounts reduces fee income.

Better risk management has been the primary contributor to our profitability through the first three quarters of 2013. Our Risk-Based Capital Ratio as of the end of third quarter 2013 stood at 16.69% as compared to

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Uwharrie Capital Corp and Subsidiaries

Consolidated Balance Sheets

(Amounts in thousands except share and per share data)	September 30, 2013	September 30, 2012
Assets		
Cash and due from banks	\$ 7,065	\$ 6,766
Interest-earning deposits with banks	49,651	19,431
Investment securities available for sale	123,126	130,274
Loans held for sale	560	1,026
Loans held for investment	312,148	339,343
Less: Allowance for loan losses	5,259	6,883
Net loans held for investment	<u>306,889</u>	<u>332,460</u>
Interest receivable	1,618	1,935
Premises and equipment, net	13,885	14,968
Restricted stock	1,319	2,265
Bank-owned life insurance	6,486	6,354
Other real estate owned	9,264	8,947
Goodwill	-	987
Other assets	11,119	9,490
Total assets	<u>\$ 530,982</u>	<u>\$ 534,903</u>
Liabilities		
Deposits:		
Demand, noninterest-bearing	\$ 78,694	\$ 66,630
Interest checking and money market accounts	225,546	203,098
Savings accounts	46,928	43,392
Time deposits, \$100,000 and over	45,910	55,746
Other time deposits	65,906	81,534
Total deposits	<u>462,984</u>	<u>450,400</u>
Interest payable	231	277
Short-term borrowed funds	6,004	20,635
Long-term debt	11,165	12,676
Other liabilities	7,521	4,509
Total liabilities	<u>487,905</u>	<u>488,497</u>
Redeemable common stock held by Employee Stock Ownership Plan (ESOP)	1,647	1,584
Shareholders' Equity		
Preferred stock, no par value: 10,000,000 shares authorized; 2,258 and 10,000 shares of series A issued and outstanding	2,258	10,000
500 shares of series B issued and outstanding	500	500
Discount on preferred stock	(25)	(125)
Common stock, \$1.25 par value: 20,000,000 shares authorized; issued and outstanding or in process of issuance 7,478,204 and 7,522,902 shares, respectively. Book value per share \$4.14 in 2013 and \$4.58 in 2012.	9,339	9,404
Additional paid-in capital	12,049	13,828
Unearned ESOP compensation	(874)	(883)
Undivided profits	10,658	11,258
Accumulated other comprehensive income (loss)	(234)	2,424
Total Uwharrie Capital shareholders' equity	<u>33,671</u>	<u>46,406</u>
Noncontrolling interest	7,759	-
Total shareholders' equity	<u>41,430</u>	<u>46,406</u>
Total liabilities and shareholders' equity	<u>\$ 530,982</u>	<u>\$ 536,487</u>

Uwharrie Capital Corp and Subsidiaries

Consolidated Statements of Income

(Amounts in thousands except share and per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Interest Income				
Interest and fees on loans	\$ 4,368	\$ 4,809	\$ 13,244	\$ 14,957
Interest on investment securities	486	595	1,188	1,455
Interest-earning deposits with banks and federal funds sold	24	29	133	101
Total interest income	4,878	5,433	14,565	16,513
Interest Expense				
Interest paid on deposits	454	623	1,488	1,948
Interest on borrowed funds	183	278	643	874
Total interest expense	637	901	2,131	2,822
Net Interest Income				
	4,241	4,532	12,434	13,691
Provision for loan losses	227	391	(547)	1,094
Net interest income after provision for loan losses	4,014	4,141	12,981	12,597
Noninterest Income				
Service charges on deposit accounts	408	450	1,205	1,318
Other service fees and commissions	870	801	2,504	2,392
Gain (loss) on sale of securities	-	-	14	16
Gain on sale of other assets	53	(80)	278	216
Income from mortgage loan sales	361	1,102	1,843	2,578
Other income	118	107	342	345
Total noninterest income	1,810	2,380	6,186	6,865
Noninterest Expense				
Salaries and employee benefits	3,037	3,215	9,189	9,478
Occupancy expense	295	293	845	863
Equipment expense	180	185	534	556
Data processing	186	204	578	638
Other operating expenses	1,860	2,253	6,326	6,003
Total noninterest expense	5,558	6,150	17,472	17,538
Income before income taxes	266	371	1,695	1,924
Provision for income taxes	48	109	557	561
Net Income	\$ 218	\$ 262	\$ 1,138	\$ 1,363
Consolidated net income				
	\$ 218	\$ 262	\$ 1,138	\$ 1,363
Less: Net income attributable to noncontrolling interest	(111)	-	(328)	-
Net income attributable to Uwharrie Capital	\$ 107	\$ 262	\$ 810	\$ 1,363
Dividends - preferred stock	(64)	(161)	(290)	(484)
Net income available to common shareholders	\$ 43	\$ 101	\$ 520	\$ 879
Net Income Per Common Share				
Basic	\$ 0.01	\$ 0.01	\$ 0.07	\$ 0.12
Assuming dilution	\$ 0.01	\$ 0.01	\$ 0.07	\$ 0.12
Weighted Average Common Shares Outstanding				
Basic	7,268,763	7,379,657	7,287,482	7,416,453
Assuming dilution	7,268,763	7,379,957	7,287,482	7,416,453

Uwharrie Capital Corp

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16.26% at the end of third quarter 2012 and is well in line with peers. Classified Assets and Other Real Estate Owned continues to decline. Non-accrual loans are at their lowest level in three years. Reduction in required loan loss reserves has contributed \$1.6 million in before tax income year-to-date 2013. Net income improved \$62 thousand from \$156 thousand in the second quarter of 2013 to \$218 thousand at the end of the third quarter 2013. Year-to-date Net Income After Tax was \$1.14 million and, after dividends, Net Income available to common shareholders is \$520 thousand for 2013, which represents 7 cents per common share. Net income for the same period last year was \$1.36 million, with earnings available for common shareholders after taxes and dividends on preferred at \$879 thousand or 12 cents per common share. Earnings are down year-to-date when compared to the same period last year, primarily due to the write-down of \$687 thousand on one large OREO property during the second quarter. The collateral sale of that loan occurred after quarter-end. Management anticipates some recovery of this write-down during the fourth quarter.

On October 16, 2013, management of your Company announced the repayment of the Fixed Rate Cumulative Perpetual Preferred Stock, Series A originally issued to the U.S. Department of the Treasury under the Troubled Asset Relief Program (TARP). This was accomplished with the successful completion of Uwharrie Bank's \$2.8 million final preferred stock offering. In early 2008, the State Banking Commissioner of North Carolina encouraged all state chartered banks, if they qualified, to take the TARP funds. At the time, the Commissioner was concerned with the depth and severity of the pending economic crisis and wanted to make sure that North Carolina state chartered banks had surplus capital. Uwharrie Capital was well capitalized and qualified for the TARP funds; therefore, management heeded the advice of the Commissioner.

The TARP program was widely misunderstood by the public, but the bank portion of the fund served the purpose of stabilizing the financial industry in a time of national panic and crisis. In the final analysis, the program did its job while contributing a profit to the U.S. Treasury and the taxpayer. Hopefully, this marks the beginning of a new era of renewed prosperity for our community and the national and world economies.

Your Company has maintained profitability through these challenging times. We go forward with the confidence that our plan for improving operational efficiency and delivery of our services will return our profitability to levels that properly reward our stockholders. We continue to be focused on people, community and *making a difference* in the world we live in. Our name has changed, but our values remain the same. As a result, our share of the market continues to grow.

In keeping with tradition, we enclose your Uwharrie Capital Corp 2014 Community Calendar. The calendar gives a glimpse into the past with scenes from the long, rich history that drug stores have served in the communities that comprise the markets served by your Company. We thank you for your confidence and continued support and would like to take this opportunity to wish you and your family many blessings during the coming holiday season.

Sincerely,

UWHARRIE CAPITAL CORP



Roger L. Dick
President and Chief Executive Officer



Brendan P. Duffey
Chief Operating Officer

This Report may contain, among other things, certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including, without limitation, (i) statements regarding certain of the Company's goals and expectations with respect to earnings, income per share, revenue, expenses and the growth rate in such items, as well as other measures of economic performance, including statements relating to estimates of credit quality trends, and (ii) statements preceded by, followed by or that include the words "may," "could," "should," "would," "believe," "anticipate," "estimate," "expect," "intend," "plan," "projects," "outlook," or similar expressions. These statements are based upon the current belief and expectations of the Company's management and are subject to significant risks and uncertainties that are subject to change based on various factors (many of which are beyond the Company's control).