AGCO CORP /DE
Form POS AM
August 20, 2004

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**As filed with the Securities and Exchange Commission on August 20, 2004**

**Registration No. 333-113560**

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

**POST-EFFECTIVE**
**AMENDMENT NO. 2**
**to the**

**Form S-3**

**REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933**

**AGCO Corporation**
*(Exact name of registrant as specified in its charter)*

| | |
|---|---|
| **Delaware** | **58-1960019** |
| *(State or other jurisdiction of incorporation or organization)* | *(I.R.S. Employer Identification No.)* |

**4205 River Green Parkway**
**Duluth, Georgia 30096**
**(770) 813-9200**
*(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)*

**Stephen D. Lupton**
**Senior Vice President of Corporate Development and General Counsel**
**AGCO Corporation**
**4205 River Green Parkway**
**Duluth, Georgia 30096**
**(770) 813-9200**
*(Name, address, including zip code, and telephone number, including area code, of agent for service)*

***With copies to:***

W. Brinkley Dickerson, Jr.
Troutman Sanders LLP
600 Peachtree Street, Suite 5200
Atlanta, Georgia 30308-2216
(404) 885-3000

**Approximate date of commencement of proposed sale to the public:** From time to time after the effective date of this registration statement.

If the only securities being registered on this form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. [ ]

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, as amended, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. [X]

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. [ ]

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. [ ]

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. [ ]

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## Explanatory Note

The purpose of this Post-Effective Amendment No. 2 to the Registration Statement on Form S-3 of AGCO Corporation (333-113560) is to amend the table under the caption Selling Securityholders in the prospectus to add the names of the selling securityholders who have requested inclusion in the prospectus since July 7, 2004, the date of Post-Effective Amendment No. 1 to the Registration Statement.

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**The information contained in this prospectus is not complete and may be changed. The selling securityholders may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.**

**SUBJECT TO COMPLETION, DATED August 20, 2004**

**PROSPECTUS**

**$201,250,000**

**AGCO Corporation**

**1 ¾% Convertible Senior Subordinated Notes due 2033**
**and the Shares of Common Stock Issuable Upon Conversion of the Notes**

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We issued the notes in a private placement in December 2003. This prospectus will be used by selling securityholders to resell their notes and the shares of our common stock issuable upon conversion of their notes. We will not receive any proceeds from the sale of these notes or these shares.

The notes are convertible into shares of our common stock at a rate of 44.7193 shares per $1,000 principal amount of the notes, subject to adjustment as described in this prospectus. Our common stock is listed on the New York Stock Exchange under the symbol AG. On August 19, 2004, the last reported sale price of our common stock on the New York Stock Exchange was $19.26 per share. The securities offered by this prospectus may be offered by the selling securityholders in negotiated transactions or otherwise, at negotiated prices or at the market prices prevailing at the time of sale.

The notes will accrue interest at an annual rate of 1¾%. We will pay interest on the notes on June 30 and December 31 of each year, beginning June 30, 2004. The notes are not secured and are subordinated to all of our senior indebtedness.

Beginning January 1, 2011, we may redeem any of the notes at a redemption price of 100% of their principal amount, plus accrued interest. Holders may require us to repurchase the notes at a repurchase price of 100% of their principal amount, plus accrued interest on December 31 of 2010, 2013, 2018, 2023 and 2028.

The notes sold using this prospectus, however, will no longer be eligible for trading on PORTAL. We do not intend to apply for listing of the notes on any securities exchange or for the inclusion of the notes in any automated quotation system.

**The securities offered hereby involve significant risks and uncertainties. These risks are described under the caption Risk Factors beginning on page 5 of this prospectus. You should consider these Risk Factors before purchasing these securities.**

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this prospectus is August ___, 2004.

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## WHERE YOU CAN FIND MORE INFORMATION

### Available Information

We file reports, proxy statements and other information with the SEC. You may obtain copies of this information by mail from the Public Reference Room of the SEC, 450 Fifth Street, N.W., Room 1024, Washington, D.C. 20549, at prescribed rates. Further information on the operation of the SEC s Public Reference Room in Washington, D.C. can be obtained by calling the SEC at 1-800-SEC-0330. The SEC also maintains an internet site at www.sec.gov that contains reports, proxy statements and other information regarding registrants like us that file electronically. Reports, proxy statements and other information concerning us also may be inspected at the offices of the New York Stock Exchange, 20 Broad Street, New York, New York 10005. We also maintain an internet site at www.agcocorp.com that contains information concerning us and our affiliates. The information at our internet site is not incorporated by reference in this prospectus, and you should not consider it to be a part of this prospectus.

### Incorporation by Reference

The rules of the SEC allow us to incorporate by reference information into this prospectus, which means that we can disclose important information to you by referring you to another document filed separately with the SEC. The information incorporated by reference is deemed to be part of this prospectus, and later information that we file with the SEC will automatically update and supersede that information. We incorporate by reference the following documents that we have filed with the SEC (SEC File No. 1-12930):

Our Annual Report on Form 10-K for the fiscal year ended December 31, 2003;

Our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2004 and June 30, 2004;

Our proxy statement relating to our Annual Meeting of Stockholders held on April 22, 2004 (other than the material contained under the headings Audit Committee Report, Compensation Committee Report on Executive Compensation and Performance Graph );

Our Current Reports on Form 8-K dated January 7, 2004, January 8, 2004, March 24, 2004, April 5, 2004, April 15, 2004, April 23, 2004, June 2, 2004 and July 7, 2004; and

The description of our common stock contained in our Registration Statement on Form 8-A dated March 17, 1992, as amended by Amendment No. 1 on Form 8-A/A dated August 19, 1999.

We are also incorporating by reference the documents that we file with the SEC pursuant to Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 between the date of this prospectus and the termination of the offering of securities contemplated hereby. In no event, however, will any of the information that we disclose under Item 9 or Item 12 of any Current Report on Form 8-K that we may from time to time file with the SEC be incorporated by reference into, or otherwise a part of, this prospectus.

We will provide without charge to each person, including any beneficial owner, to whom a copy of this prospectus has been delivered, a copy of any and all of these filings. You may request a copy of these filings by writing or telephoning us at:

Investor Relations
AGCO Corporation
4205 River Green Parkway
Duluth, Georgia 30096

(770) 813-9200

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## SUMMARY

This summary contains basic information about us and this offering. Because it is a summary, it does not contain all of the information that you should consider before investing. You should read this entire prospectus carefully, including the section entitled Risk Factors and any additional information incorporated by reference and described above under the heading Where You Can Find More Information, before you invest.

Unless otherwise mentioned or unless the context requires otherwise, all references in this prospectus to AGCO, we, us, our or similar references mean AGCO Corporation and its subsidiaries and not to the selling securityholders.

## OUR COMPANY

We are the third largest manufacturer and distributor of agricultural equipment and related replacement parts in the world based on annual net sales. We sell a full range of agricultural equipment, including tractors, combines, self-propelled sprayers, hay tools, forage equipment and implements. Our products are widely recognized in the agricultural equipment industry and are marketed under a number of brand names including AGCO®, AgcoAllis®, AgcoStar®, Ag-Chem®, Challenger®, Farmhand®, Fendt®, Fieldstar®, Gleaner®, Glencoe®, Hesston®, Lor*Al®, Massey Ferguson®, New Idea®, RoGator®, Soilteq®, Spra-Coupe®, Sunflower®, Terra-Gator®, Tye®, White® and Willmar®. We distribute most of our products through a combination of approximately 8,400 independent dealers and distributors, associates and licensees in more than 140 countries. In addition, we provide retail financing in North America, the United Kingdom, France, Germany, Ireland and Brazil through our finance joint ventures with Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A., which we refer to as Rabobank. As a result of the Valtra acquisition consummated on January 5, 2004, which is discussed below, we also began marketing under the Valtra® and SISUDiesel brand names. Depending on the markets, we distribute these products directly to end customers or through Valtra s 820 independent dealers and distributors.

Since our formation in June 1990, we have grown substantially through a series of over 20 acquisitions. We have been able to expand and strengthen our independent dealer network, introduce new tractor product lines and complementary non-tractor products in new markets and expand our replacement parts business to meet the needs of our customers.

On January 5, 2004, we acquired the Valtra tractor and diesel engine operations of Kone Corporation, a Finnish company, for 606.1 million net of approximately 19.8 million cash acquired (or approximately $760 million net). Valtra is a global tractor and off-road engine manufacturer with market leadership positions in the Nordic region of Europe and Latin America. Unaudited pro forma combined financial information with respect to our acquisition of Valtra is included beginning on page P-1 of this prospectus.

The address of our principal executive offices is 4205 River Green Parkway, Duluth, Georgia 30096, and our telephone number is (770) 813-9200. Our internet site is www.agcocorp.com. Information contained on our internet site is not incorporated by reference into this prospectus. You should not consider information contained on our internet site to be a part of this prospectus.

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## SUMMARY OF THE NOTES AND COMMON STOCK

| | |
|---|---|
| Securities Offered | $201,250,000 principal amount of 1 ¾% Convertible Senior Subordinated Notes due 2033, held by various selling securityholders.<br><br>Up to 8,999,759 shares of AGCO common stock, subject to adjustment upon certain events (for resale by selling securityholders after conversion of the notes), issuable by AGCO upon conversion of the notes. |
| Maturity Date | December 31, 2033. |
| Interest | 1 ¾% per annum on the principal amount, payable semi-annually in arrears in cash on June 30 and December 31 of each year, beginning June 30, 2004. |
| Conversion | You may convert the notes into shares of our common stock at a conversion rate of 44.7193 shares per $1,000 principal amount of notes, subject to adjustment, prior to the close of business on the final maturity date under any of the following circumstances:<br><br>during any fiscal quarter commencing after March 31, 2004, if the closing sale price of our common stock exceeds 120% of the conversion price for at least 20 trading days in the 30 consecutive trading days ending on the last trading day of the preceding fiscal quarter; or<br><br>during the five business day period after any five consecutive trading day period in which the trading price per note for each day of such period was less than 98% of the product of the closing sale price of our common stock and the number of shares issuable upon conversion of $1,000 principal amount of the notes; or<br><br>if the notes have been called for redemption; or<br><br>upon the occurrence of specified corporate transactions described under Description of Notes. |
| Subordination | The notes will be subordinated to all of our existing and future senior indebtedness and are effectively subordinated to all debt and other liabilities of our subsidiaries. |
| Redemption | We may redeem any of the notes beginning January 1, 2011, by giving you at least 30 days notice. We may redeem the notes either in whole or in part at a redemption price equal to 100% of their principal amount, plus accrued and unpaid interest. |
| Fundamental Change | If a fundamental change (as described under Description of Notes Repurchase at Option of the Holder Upon a Fundamental Change ) occurs prior to maturity, you may require us to repurchase all or part of your notes at a repurchase price equal to 100% of their principal amount, plus accrued and unpaid interest. You may require us to repurchase the notes on December 31 of 2010, 2013, |

| | |
|---|---|
| Repurchase at the Option of the Holder | 2018, 2023 and 2028, at a repurchase price equal to 100% of their principal amount, plus accrued and unpaid interest. |
| Use of Proceeds | We will not receive any proceeds from the sale of the notes or the shares of common stock offered by this prospectus. |

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| Registration Rights. | We have entered into a registration rights agreement with the initial purchasers. In the registration rights agreement, we agreed to file this shelf registration statement with the SEC covering resale of the registrable securities within 90 days after the closing date. We agreed to use our best efforts to cause the shelf registration statement to become effective within 180 days of the closing date and to use our best efforts to keep the registration statement effective until either of the following has occurred:<br><br>all securities covered by the registration statement have been sold; or<br><br>the expiration of the applicable holding period with respect to the notes and the underlying common stock under Rule 144(k) under the Securities Act of 1933, or any successor provision. |
| New York Stock Exchange Symbol. | AG |

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## RATIO OF EARNINGS TO FIXED CHARGES

Our consolidated ratio of earnings to fixed charges is computed by dividing earnings by fixed charges. The following table shows our consolidated ratio of earnings to fixed charges for the six months ended June 30, 2004 and 2003, respectively, and for each of the last five fiscal years ended December 31:

| | Six Months Ended June 30, | | Year Ended December 31, | | | | |
|---|---|---|---|---|---|---|---|
| | 2004 | 2003 | 2003 | 2002 | 2001 | 2000 | 1999 |
| Ratios of earnings to fixed charges[a] | 2.9 | 2.0 | 2.5 | 1.5 | 1.4 | | |

(a) For purposes of computing the ratio of earnings to fixed charges, earnings consist of income before income taxes and distributed earnings of less-than-50%-owned affiliates, plus fixed charges. Fixed charges consist of interest costs (whether expensed or capitalized), amortization of debt issuance costs, an estimate of the interest cost in rental expense and the proportionate share of fixed charges of 50% owned affiliates. The deficiency of the earnings to fixed charges in 2000 was $4.2 million and in 1999 was $19.2 million.

## RISK FACTORS

*Investing in the notes and our common stock involves risks. In deciding whether to invest in the notes and our common stock, you should carefully consider the following risk factors, in addition to the other information contained or incorporated by reference in this prospectus. If any of the following events occur, our business, financial condition or results of operations could be materially and adversely affected. In that case, the value of the notes and our common stock could decline and you may lose all or part of your investment.*

### Risks Relating to Our Business

***Our financial results depend heavily upon the agricultural industry, and factors that adversely affect the agricultural industry generally will adversely affect our results of operations and financial condition.***

Our success depends heavily on the vitality of the agricultural industry. Historically, the agricultural industry, including the agricultural equipment business, has been cyclical and subject to a variety of economic factors, governmental regulations and legislation, and weather conditions. Sales of agricultural equipment generally are related to the health of the agricultural industry, which is affected by farm income and debt levels, farm land values, and farm cash receipts, all of which reflect levels of commodity prices, acreage planted, crop yields, demand, government policies and government subsidies. Sales also are influenced by economic conditions, interest rate and exchange rate levels, and the availability of retail financing. Trends in the industry, such as farm consolidations, may affect the agricultural equipment market. In addition, weather conditions, such as heat waves or droughts, and pervasive livestock diseases can affect farmers buying decisions. Downturns in the agricultural industry due to these and other factors are likely to result in decreases in demand for agricultural equipment, which could adversely affect our sales, growth, results of operations and financial condition. During previous downturns in the farm sector, we experienced significant and prolonged declines in sales and profitability, and we expect our business to remain subject to similar market fluctuations in the future.

***Our success depends on the introduction of new products, which will require substantial expenditures.***

Our long-term results depend upon our ability to introduce and market new products successfully. The success of our new products will depend on a number of factors, including:

- customer acceptance;
- the efficiency of our suppliers in providing component parts;
- the economy;
- competition; and
- the strength of our dealer networks.

As both we and our competitors continuously introduce new products or refine versions of existing products, we cannot predict the level of market acceptance or the amount of market share our new products will achieve. Any manufacturing delays or problems with our new product launches could adversely affect our operating results. We have experienced delays in the introduction of new products in the past, and we cannot assure you that we will not experience delays in the future. In addition, introducing new products could result in a decrease in revenues from our existing products. Consistent with our strategy of offering new products and product refinements, we expect to continue to use a substantial amount of capital for further product development and refinement. We may need more capital for product development and refinement than is available to us, which could adversely affect our business, financial condition or results of operations.

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***Rationalization of manufacturing facilities may cause production capacity constraints and inventory fluctuations, which could adversely affect our results of operations and financial condition.***

The rationalization of our manufacturing facilities has at times resulted in, and similar rationalizations in the future may result in, temporary constraints upon our ability to produce product quantities necessary to fill orders and thereby complete sales in a timely manner. A prolonged delay in our ability to fill orders on a timely basis could affect customer demand for our products and increase the size of our product inventories, causing future reductions in our manufacturing schedules and adversely affecting our results of operations. For example, we recently transferred a portion of our production from our Coventry, England facility to our Beauvais, France facility. After this transfer, several suppliers to the Beauvais facility were unable to supply necessary components and parts in a timely manner. As a result, we were not able to meet our manufacturing and sales objectives for products produced at that facility and recently temporarily reduced our manufacturing targets to address these issues. Moreover, our continuous development and production of new products will often involve the retooling of existing manufacturing facilities. This retooling may limit our production capacity at certain times in the future, which could adversely affect our results of operations and financial condition.

***We depend on suppliers for components and parts for our products, and any failure by our suppliers to provide products as needed or by us to promptly address supplier issues will adversely impact our ability to timely and efficiently manufacture and sell products.***

Our products include components and parts manufactured by others. As a result, our ability to timely and efficiently manufacture existing products, to introduce new products and to shift manufacturing of products from one facility to another depends on the quality of these components and parts and the timeliness of their delivery to our facilities. At any particular time, we depend on many different suppliers and the failure by one or more of our suppliers to perform as needed will result in fewer products being manufactured, shipped and sold. If the quality of the components or parts provided by our suppliers is less than required and we do not recognize that failure prior to the shipment of our products, we will incur higher warranty costs. The timely supply of component parts for our products also depends on our ability to manage our relationships with suppliers, to identify and replace suppliers that have failed to meet our schedules or quality standards, and to monitor the flow of components and accurately project our needs.

***We have significant international operations and, as a result, we are exposed to risks related to foreign laws, taxes, economic conditions, labor supply and relations, political conditions and governmental policies. These risks may delay or reduce our realization of value from our international operations.***

For the fiscal year ended December 31, 2003, we derived approximately $2.3 billion or 66.3% of our revenues from sales outside North America. The primary foreign countries in which we do business are Germany, France, Brazil, the United Kingdom and Finland. In addition, we have significant manufacturing operations in France, Germany, Brazil, Denmark and Finland. Our results of operations and financial condition may be adversely affected by the laws, taxes, economic conditions, labor supply and relations, political conditions and governmental policies of the foreign countries in which we conduct business. Some of our international operations also are subject to various risks that are not present in domestic operations, including restrictions on dividends and the repatriation of funds. Foreign developing markets may present special risks, such as unavailability of financing, inflation, slow economic growth and price controls.

Domestic and foreign political developments and government regulations and policies directly affect the international agricultural industry, which affects the demand for agricultural equipment. If demand for agricultural equipment declines, our sales, growth, results of operations and financial condition may be adversely affected. The application, modification or adoption of laws, regulations, trade agreements or policies adversely affecting the agricultural industry, including the imposition of import and export duties and quotas, expropriation and potentially burdensome taxation, could have an adverse effect on our business. The ability of our international customers to operate their businesses and the health of the agricultural industry in general are affected by domestic and foreign government programs that provide economic support to farmers. As a result, farm income levels and the ability of farmers to obtain advantageous financing and other protections would be reduced to the extent that any such programs are curtailed or eliminated. Any such reductions would likely result in a decrease in demand for agricultural equipment. For example, a decrease or elimination of current price protections for commodities or of subsidy payments for farmers in the European Union, the United States, Brazil or elsewhere in South America could negatively impact the operations of farmers in those regions, and, as a result, our sales may decline if these farmers delay, reduce or cancel purchases of our products.

***We are subject to currency exchange rate fluctuations and interest rate changes, which could adversely affect our financial performance.***

We conduct operations in many areas of the world involving transactions denominated in a variety of currencies. Our production costs, profit margins and competitive position are affected by the strength of the currencies in countries where we manufacture or purchase goods relative to the strength of the currencies in countries where our products are sold. In addition, we are subject to currency exchange rate risk to the extent that our costs are denominated in currencies other than those in which we earn revenues and to risks associated with translating the financial statements of our foreign subsidiaries from local currencies into United States dollars. Similarly, changes in interest rates affect our results of operations by increasing or decreasing borrowing costs and finance income. Our most significant transactional foreign currency exposures are the Euro, Brazilian real and the Canadian dollar in relation to the United States dollar. Where naturally offsetting currency positions do not occur, we attempt to manage these risks by hedging some, but not all, of our exposures through the use of foreign currency forward exchange contracts. As with all hedging instruments, there are risks associated with the use of foreign currency forward exchange contracts, interest rate swap agreements and other risk management contracts. While the use of such hedging instruments provides us with protection from certain fluctuations in currency exchange and interest rates, we potentially forego the benefits that might result from favorable fluctuations in currency exchange and interest rates. In addition, any default by the counterparties to these transactions could adversely affect us. Despite our use of financial hedging transactions, we cannot assure you that currency exchange rate or interest rate fluctuations will not adversely affect our results of operations, cash flow, financial condition or the price of our notes and common stock.

***We are subject to extensive environmental laws and regulations, and our costs related to compliance with, or our failure to comply with, existing or future laws and regulations could adversely affect our business and results of operations.***

We are subject to increasingly stringent environmental laws and regulations in the countries in which we operate. These regulations govern, among other things, emissions into the air, discharges into water, the use, handling and disposal of hazardous substances, waste disposal and the remediation of soil and groundwater contamination. Our costs of complying with these or any other current or future environmental regulations may be significant. For example, the European Union and the United States have adopted more stringent environmental regulations regarding emissions into the air. As a result, we will likely incur increased capital expenses to modify our products to comply with these regulations. Further, we may experience production delays if we or our suppliers are unable to design and manufacture components for our products that comply with environmental standards established by regulators. For example, our engine suppliers are subject to air quality standards, and production at our facilities could be impaired if these suppliers are unable to timely respond to any changes in environmental laws and regulations affecting engine emissions. Compliance with environmental and safety regulations has added and will continue to add to the cost of our products and increase the capital-intensive nature of our business. We cannot assure you that we will not be adversely impacted by costs, liabilities or claims with respect to our operations under existing laws or those that may be adopted in the future. If we fail to comply with existing or future laws and regulations, we may be subject to governmental or judicial fines or sanctions and our business and results of operations could be adversely affected.

***Our labor force is heavily unionized, and our contractual and legal obligations under collective bargaining agreements and labor laws may subject us to greater risks of work interruption or stoppage and could cause our costs to be higher.***

Most of our employees, principally at our manufacturing facilities, are represented by collective bargaining agreements with contracts that expire on varying dates. Several of our collective bargaining agreements are of limited duration and, therefore, must be re-negotiated frequently. As a result, we could incur significant administrative expenses associated with union representation of our employees. Furthermore, we are at greater risk of work interruptions or stoppages than non-unionized companies, and any work interruption or stoppage could significantly impact the volume of goods we have available for sale. In addition, collective bargaining agreements and labor laws may impair our ability to reduce our labor costs by streamlining existing manufacturing facilities and in restructuring our business because of limitations on personnel and salary changes and similar restrictions.

***We have significant pension obligations with respect to our employees.***

A portion of our active and retired employees participate in defined benefit pension plans under which we are obligated to provide prescribed levels of benefits regardless of the value of the underlying assets, if any, of the applicable pension plan. If our obligations under a plan are unfunded or underfunded, we will have to use cash flow from operations and other sources to pay our obligations either as they become due or over some shorter funding period. As of December 31, 2003, we had approximately $232.0 million in unfunded or underfunded obligations related to our pension and other post-retirement health care benefits.

***The agricultural equipment industry is highly seasonal, and seasonal fluctuations may adversely affect our quarterly results of operations, cash flows and financial condition.***

The agricultural equipment business is highly seasonal, which causes our quarterly results to fluctuate during the year. December is typically our largest month for retail sales because our customers purchase a higher volume of our products at year end with funds from their completed harvests and when dealer incentives are greatest. In addition, farmers purchase agricultural equipment in the Spring and Fall in conjunction with the major planting and harvesting seasons. Our net sales and income from operations have historically been the lowest in the first quarter and have increased in subsequent quarters as dealers increase inventory in anticipation of increased retail sales in the third and fourth quarters.

***We face intense competition and, if we are unable to compete successfully against other agricultural equipment manufacturers, we could lose customers and our revenues and profitability may decline.***

The agricultural equipment business is highly competitive, particularly in North America, Europe and Latin America. We compete with several large national and international companies that, like us, offer a full line of agricultural equipment. We also compete with numerous short-line and specialty manufacturers and suppliers of farm equipment products. Our two key competitors, Deere & Co. and CNH Global, are substantially larger than we are and have greater financial and other resources. In addition, in some markets, we compete with smaller regional competitors with significant market share in a single country or group of countries. We cannot assure you that these competitors will not substantially increase the resources devoted to the development and marketing, including discounting, of products that compete with our products. If we are unable to compete successfully against other agricultural equipment manufacturers, we could lose customers and our revenues and profitability may decline. There also can be no assurances that consumers will continue to regard our agricultural equipment favorably, and we may be unable to develop new products that appeal to consumers or unable to continue to compete successfully in the agricultural equipment business. In addition, competitive pressures in the agricultural equipment business may affect the market prices of new and used equipment, which, in turn, may adversely affect our sales margins and results of operations.

## Risks Relating to the Valtra Acquisition

***We can provide no assurances that our acquisition of Valtra will be approved by the Brazilian competition authority.***

We have applied to the Brazilian competition authority for its approval of our purchase of Valtra. At this time, we cannot predict with certainty when or whether the Brazilian competition authority will grant its approval. Under

Brazilian law, we were permitted to complete the purchase of Valtra without having received such approval; however, the Brazilian competition authority has, while considering our request for approval, imposed conditions on how we operate both Valtra s Brazilian business and our existing Brazilian business. These conditions include a requirement to maintain all manufacturing facilities, brands, products and distribution channels that existed prior to the acquisition. The timing and the conditions of such approval may delay or prevent us from fully executing our business plan for operating the Valtra business and our existing business or may force us to sell a portion of the Valtra business or our existing business. Any of these events could adversely affect our financial condition and results of operations.

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***We may encounter difficulties in integrating Valtra into our business and may not fully achieve, or achieve within a reasonable time frame, expected strategic objectives, cost savings and other expected benefits of the acquisition.***

We expect to realize strategic and other benefits as a result of our acquisition of Valtra, including, among other things, access to Valtra s customers in the Nordic and Latin American regions, its research and development capabilities and its engine technology, which can be used with several of our tractor platforms. However, it is impossible to predict with certainty whether, or to what extent, these benefits will be realized or whether we will be able to integrate Valtra in a timely and effective manner. In addition:

- the costs of integrating Valtra and its operations may be higher than we expect and may require significant attention from our management; and

- our ability to successfully carry out our growth strategy for Valtra will be affected by, among other things, our ability to maintain and enhance our relationships with existing Valtra customers, changes in the spending patterns and preferences of such customers, and fluctuating economic and competitive conditions.

Our ability to address these issues will determine the extent to which we are able to successfully integrate, develop and grow the Valtra business and to realize the expected benefits of the transaction. Our failure to do so could have a material adverse effect on our revenues, operating results and financial condition following the transaction and could cause the value of our notes and common stock to decline.

***Valtra operates certain business segments that are significantly different from ours, and we face new risks associated with conducting the Valtra business.***

Valtra manufactures and sells diesel engines and is subject to regulations and demands that are different from our core business. We do not have experience in operating an engine manufacturing business and may be unable to achieve the same growth, sales levels and profitability as Valtra has in the past. We also are unfamiliar with the risks that are peculiar to the engine manufacturing industry. For example, engine manufacturers are subject to environmental standards that are adjusted by regulators from time to time to minimize harmful emissions into the air. If we are unable to design and manufacture engines that comply with these changing regulations, Valtra s introduction of competitive products to the marketplace may be delayed indefinitely. Further, since Valtra supplies us with engines for our products, production at our facilities could be impaired if Valtra is unable to timely respond to regulatory changes. We cannot predict with certainty our ability to effectively operate the Valtra business, and, consequently, our results of operations and financial condition could be negatively impacted following the acquisition.

## Risks Relating to the Notes

***We have a substantial amount of indebtedness, which may adversely affect our ability to operate and expand our business.***

We have a significant amount of indebtedness. As of June 30, 2004, we had total long-term indebtedness of approximately $1,136.9 million, stockholders equity of approximately $1,243.5 million and a ratio of long-term indebtedness to equity of .91 to 1.0. We also had short-term obligations of $14.5 million, capital lease obligations of $1.6 million, unconditional purchase or other long-term obligations of $290.2 million, and amounts owed under an accounts receivable securitization facility of $438.4 million. In addition, we had guaranteed indebtedness owed to third parties of approximately $69.2 million, primarily related to dealer and end-user financing of equipment.

Our substantial indebtedness could have important adverse consequences. For example, it could:

require us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, which would reduce the availability of our cash flow to fund future working capital, capital expenditures, acquisitions and other general corporate purposes;

increase our vulnerability to general adverse economic and industry conditions;

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limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;

restrict us from introducing new products or pursuing business opportunities;

place us at a competitive disadvantage compared to our competitors that have relatively less indebtedness;

limit, along with the financial and other restrictive covenants in our indebtedness, among other things, our ability to borrow additional funds or pay cash dividends; and

prevent us from selling additional receivables to our commercial paper conduit. The European facility agreement provides that the agent, Rabobank, has the right to terminate the securitization facilities if our senior unsecured debt rating moves below B+ by Standard & Poor s or B1 by Moody s Investor Services. Based on our current ratings, a downgrade of two levels by either Standard & Poor s or Moody s would need to occur.

In addition, as a result of the Valtra acquisition completed on January 5, 2004, we incurred additional indebtedness. Our current financing and funding sources are the $201.3 million principal amount 1¾% convertible senior subordinated notes due 2033, the 200.0 million principal amount 6 % senior subordinated notes due 2014, the $250.0 million principal amount 9½% senior notes due 2008, approximately $484.1 million of accounts receivable securitization facilities, a $300.0 million revolving credit facility, a $277.0 million term loan facility and a 110.7 million term loan facility.

***Covenants in our debt instruments restrict or prohibit us from engaging in or entering into a variety of transactions, which could adversely affect us.***

The indentures governing our outstanding indebtedness contain various covenants that limit, among other things, our ability to:

incur additional indebtedness;

pay dividends or make distributions or certain other restricted payments;

make certain investments;

create restrictions on the payment of dividends or other amounts to us by our restricted subsidiaries;

issue or sell capital stock of restricted subsidiaries;

guarantee indebtedness;

enter into transactions with stockholders or affiliates;

create liens;

sell assets;

engage in sale-leaseback transactions; and

enter into certain mergers and consolidations.

Failing to comply with those covenants could result in an event of default which, if not cured or waived, could have a material adverse effect on our business, financial condition and results of operations.

***A breach of a covenant in our debt instruments could cause acceleration of a significant portion of our outstanding indebtedness.***

A breach of a covenant or other provision in any debt instrument governing our current or future indebtedness could result in a default under such instruments. Our ability to comply with these covenants and other provisions may be affected by events beyond our control, and we cannot assure you that we will be able to comply with these covenants and other provisions. Upon the occurrence of an event of default under any debt instrument, the lenders could elect to declare all amounts outstanding to be immediately due and payable and terminate all commitments to extend further credit. If we were unable to repay those amounts, the lenders could proceed against collateral granted to them, if any, to secure the indebtedness. If our current or future lenders accelerate the payment of the indebtedness owed to them, we cannot assure you that our assets would be sufficient to repay in full our outstanding indebtedness.

***Our subsidiaries hold a majority of our assets and conduct a majority of our operations, and they will not be obligated to make payments on the notes.***

We conduct a majority of our business through our subsidiaries. These subsidiaries directly and indirectly own a majority of the assets of our business and conduct operations themselves and through other subsidiaries. Therefore, we depend on distributions and advances from our subsidiaries and the repayment by our subsidiaries of intercompany loans and advances to meet our debt service and other obligations. Contractual provisions, laws or regulations to which we or any of our subsidiaries are or may become subject, as well as any subsidiary s financial condition and operating requirements, may limit our ability to obtain cash required to service our indebtedness, including the notes.

The notes will be structurally subordinated to all existing and future obligations of our subsidiaries, including claims with respect to trade payables. This means that the creditors of our subsidiaries have priority in their claims on the assets of our subsidiaries over our creditors, including holders of the notes.

***We may not have the ability to raise the funds necessary to finance the redemption or repurchase of the notes if required by holders pursuant to the indenture.***

In the event of a fundamental change under the indenture, we will be required to offer to redeem all outstanding notes at a price of 100% of the principal amount of the notes, plus accrued and unpaid interest to the redemption date. In addition, holders may require us to repurchase their notes on December 31 of 2010, 2013, 2018, 2023 and 2028. However, it is possible that we will not have sufficient funds available at such time to make the required redemption or repurchase of the notes. In addition, any future credit agreements or other agreements relating to our indebtedness may contain provisions prohibiting redemption of the notes under certain circumstances or expressly prohibiting our redemption of the notes upon a fundamental change or may provide that a fundamental change constitutes an event of default under that agreement. If a fundamental change occurs at a time when we are prohibited from redeeming the notes, we could seek the consent of our lenders to redeem the notes or attempt to refinance this debt. If we do not obtain consent, we would not be permitted to redeem the notes. Our failure to redeem tendered notes would constitute an event of default under the indenture, which might constitute a default under the terms of our other indebtedness.

***The price of our common stock historically has experienced significant price and volume fluctuations, which may make it difficult for you to resell the notes or the common stock into which the notes are convertible.***

Subject to certain conditions, the notes will be convertible into shares of our common stock. The market price of our common stock historically has experienced and may continue to experience significant price and volume fluctuations similar to those experienced by the broader stock market in recent years. Generally, the fluctuations experienced by the broader stock market have affected the market prices of securities issued by many companies for reasons unrelated to their operating performance and may adversely affect the price of our common stock. In addition, our announcements of our quarterly operating results, changes in general conditions in the economy or the financial markets and other developments affecting us, our affiliates or our competitors could cause the market price of our common stock to fluctuate substantially. The trading price of the notes is expected to be affected significantly by the price of our common stock.

***We may not have sufficient cash flow to make payments on the notes and our other indebtedness.***

Our ability to pay principal and interest on the notes and our other indebtedness and to fund our planned capital expenditures depends on our future operating performance. Our future operating performance is subject to a number of risks and uncertainties that are often beyond our control, including general economic conditions and financial, competitive, regulatory and environmental factors. For a discussion of some of these risks and uncertainties, see Risks Relating to Our Business. Consequently, we cannot assure you that we will have sufficient cash flow to meet our liquidity needs, including making payments on our indebtedness.

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If our cash flow and capital resources are insufficient to allow us to make scheduled payments on our debt, we may have to sell assets, seek additional capital or restructure or refinance our debt. We cannot assure you that the terms of our debt will allow for these alternative measures or that such measures would satisfy our scheduled debt service obligations.

If we cannot make scheduled payments on our debt:

- the holders of our debt could declare all outstanding principal and interest to be due and payable;

- the holders of our secured debt could commence foreclosure proceedings against our assets;

- we could be forced into bankruptcy or liquidation; and

- you could lose all or part of your investment in our notes and common stock.

***Because the notes are unsecured, they are also effectively subordinated to any of our existing and future secured debt.***

Our obligations under the notes are unsecured. In contrast, some of our other debt obligations, including our revolving credit and term facilities, are secured by a substantial portion of our assets. As a result, the notes are effectively subordinated to our obligations under our secured debt. If we are in default on these secured obligations, you may not receive principal and interest payment on your notes.

***The value of the conversion right associated with the notes may be substantially lessened or eliminated if we are party to a merger, consolidation or other similar transaction.***

If we are party to a consolidation, merger or binding share exchange or transfer or lease of all or substantially all of our assets pursuant to which our common stock is converted into, or into the right to receive, cash, securities or other property, at the effective time of the transaction, the right to convert a note into our common stock will be changed into a right to convert it into the kind and amount of cash, securities or other property that the holder would have received if the holder had converted its note immediately prior to the transaction. This change could substantially lessen or eliminate the value of the conversion privilege associated with the notes in the future. For example, if we were acquired in a cash merger, each note would become convertible solely into cash and would no longer be convertible into securities whose value would vary depending on our future prospects and other factors.

***You may only convert the notes into shares of our common stock under certain circumstances, none of which may occur.***

The notes may be converted into shares of our common stock only if one or more of the conditions described under Description of Notes are satisfied. We cannot assure you that any notes you purchase will become convertible into shares of our common stock prior to their stated maturity. If you are unable to convert your notes prior to their stated maturity, you may be unable to realize the value of the conversion rights associated with your notes.

***Conversion of the notes will dilute the ownership interest of existing stockholders.***

The conversion of some or all of the notes will dilute the ownership interest of existing stockholders. Any sales in the public market of the common stock issuable upon such conversion could adversely affect prevailing market prices of our common stock. In addition, the existence of the notes may encourage short selling by market participants because the conversion of the notes could depress the price of our common stock.

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***Adjustments to the conversion rate on the notes may result in a taxable distribution to you.***

The conversion rate of the notes will be adjusted if we distribute cash with respect to shares of our common stock and in certain other circumstances. Under Section 305(c) of the Internal Revenue Code, an increase in the conversion rate as a result of our distribution of cash to common stockholders generally will result in a deemed distribution to you. Other adjustments in the conversion rate (or failures to make such adjustments) that have the effect of increasing your proportionate interest in our assets or earnings may have the same result. Any deemed distribution to you will be taxable as a dividend to the extent of our current or accumulated earnings and profits. If you are a non-U.S. holder of notes, any deemed distribution to you that is treated as a dividend will be subject to withholding tax at a 30% rate (or such lower rate as may be specified by an applicable income tax treaty). See United States Federal Tax Considerations.

***Provisions in our stockholder rights plan and Delaware law may delay or prevent take-over attempts, which could adversely affect the value of shares of our common stock.***

Our stockholder rights plan, as amended, contains provisions that could make it harder for a third party to acquire us. The rights plan provides that each share of common stock outstanding will have attached to it the right to purchase one-hundredth of a share of Junior Cumulative Preferred Stock, or junior preferred stock. The purchase price per one-hundredth of a share of junior preferred stock is $110.00, subject to adjustment. The rights will be exercisable only if a person or group acquires 20.0% or more of our common stock or announces a tender offer or exchange offer that would result in the acquisition of 20.0% or more of our common stock or, in some circumstances, if other conditions are met. After the rights become exercisable, the plan allows stockholders, other than the acquirer, to purchase our common stock or, in some circumstances, securities of the acquiror with a then current market value of two times the exercise price of the right. The rights are redeemable for $.01 per right, subject to adjustment, at the option of our board of directors. The rights may discourage take-over attempts because they could cause substantial dilution to a person or group that attempts to acquire us on terms not approved by our board of directors. Generally, the rights should not interfere with any merger or other business combination approved by our board of directors because our board of directors may redeem the rights prior to the time we enter into a purchase and sale agreement with the acquirer. In addition, Delaware law imposes some restrictions on mergers and other business combinations between us and any holder of 15.0% or more of our outstanding common stock. Although we believe the rights plan and Delaware law provide us an opportunity to receive a higher bid by requiring potential acquirers to negotiate with our board of directors, these provisions apply even if a take-over attempt is considered beneficial by some stockholders.

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## SPECIAL NOTE ABOUT FORWARD-LOOKING STATEMENTS

Certain statements included or incorporated by reference in this prospectus reflect assumptions, expectations, projections, intentions or beliefs about future events. These statements, which may relate to such matters as our expectations with respect to the Valtra acquisition, industry conditions, net sales and income, restructuring and other infrequent expenses, impairment charges, future capital expenditures, fulfillment of working capital needs, the impact of war and political unrest and future acquisition plans, are forward-looking statements within the meaning of the federal securities laws. These statements do not relate strictly to historical or current facts, and you can identify certain of these statements, but not necessarily all, by the use of the words anticipate, assumed, indicate, estimate, believe predict, forecast, rely, expect, continue, grow and other words of similar meaning. Although we believe that t expectations and assumptions reflected in these statements are reasonable in view of the information currently available to us, there can be no assurance that these expectations will prove to be correct. These forward-looking statements involve a number of risks and uncertainties, and actual results may differ materially from the results discussed in or implied by the forward-looking statements. In addition to the specific factors discussed in the Risk Factors section in this prospectus, in our reports that are incorporated by reference and in any applicable prospectus supplement, the following are among the important factors that could cause actual results to differ materially from the forward-looking statements:

- general economic and capital market conditions;
- the worldwide demand for agricultural products;
- grain stock levels and the levels of new and used field inventories;
- government policies and subsidies;
- weather conditions;
- interest and foreign currency exchange rates;
- pricing and product actions taken by competitors;
- commodity prices, acreage planted and crop yields;
- farm income, land values, debt levels and access to credit;
- pervasive livestock diseases;
- production disruptions;
- supply and capacity constraints;
- our cost reduction and control initiatives;
- our research and development efforts;
- dealer and distributor actions;
- technological difficulties; and

political and economic uncertainty in various areas of the world.

Any forward-looking statement should be considered in light of such important factors.

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New factors that could cause actual results to differ materially from those described above emerge from time to time, and it is not possible for us to predict all of such factors or the extent to which any such factor or combination of factors may cause actual results to differ from those contained in any forward-looking statement. Any forward-looking statement speaks only as of the date on which such statement is made, and we do not undertake any obligation to update the information contained in such statement to reflect subsequent developments or information except as required by law.

## USE OF PROCEEDS

We will not receive any proceeds from the sale of the notes or the shares of common stock offered by this prospectus.

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## DESCRIPTION OF NOTES

The 1¾% Convertible Senior Subordinated Notes due December 31, 2033 (the notes ), were issued under an indenture dated as of December 23, 2003, between us, as issuer, and SunTrust Bank, as trustee. The notes and the shares issuable upon conversion of the notes are covered by a registration rights agreement between us and the initial purchasers of the notes. You may request a copy of the indenture and the registration rights agreement from the trustee.

The following description is a summary of the material provisions of the notes, the indenture and the registration rights agreement. It does not purport to be complete. This summary is subject to and is qualified by reference to all the provisions of the indenture, including the definitions of certain terms used in the indenture. Wherever particular provisions or defined terms of the indenture or form of note are referred to, these provisions or defined terms are incorporated in this prospectus by reference.

### General

We issued $201,250,000 aggregate principal amount notes in a private placement in December 2003. The notes are general unsecured obligations of AGCO. Our payment obligations under the notes are subordinated to our senior indebtedness as described under Subordination of Notes. The notes will be convertible into shares of common stock as described under - Conversion of Notes.

The notes were issued only in denominations of $1,000 and multiples of $1,000. The notes will mature on December 31, 2033 unless earlier converted, redeemed or repurchased. We may, without the consent of the holders, issue additional notes under the indenture with the same terms and with the same CUSIP numbers as the notes offered hereby in an unlimited aggregate principal amount, provided that such additional notes must be part of the same issue as the notes offered hereby for United States federal income tax purposes. We may also from time to time repurchase the notes in open market purchases or negotiated transactions without prior notice to holders.

Neither we nor any of our subsidiaries will be subject to any financial covenants under the indenture. In addition, neither we nor any of our subsidiaries are restricted under the indenture from paying dividends, incurring debt, or issuing or repurchasing our securities.

You are not afforded protection under the indenture in the event of a highly leveraged transaction or a change in control of us except to the extent described below under Redemption at Option of the Holder Upon a Fundamental Change.

We will pay interest on June 30 and December 31 of each year, beginning June 30, 2004, to record holders at the close of business on the preceding June 15 and December 15, as the case may be, except interest payable upon redemption or repurchase will be paid to the person to whom principal is payable, unless the redemption date or repurchase date, as the case may be, is an interest payment date.

We will maintain an office in the Borough of Manhattan, The City of New York, for the payment of interest, which shall initially be an office or agency of the trustee. We may pay interest either:

- by check mailed to your address as it appears in the note register, provided that if you are a holder with an aggregate principal amount in excess of $2.0 million, you shall be paid, at your written election, by wire transfer in immediately available funds; or
- by transfer to an account maintained by you in the United States.

However, payments to The Depository Trust Company, New York, New York, which we refer to as DTC, will be made by wire transfer of immediately available funds to the account of DTC or its nominee. Interest will be computed on the basis of a 360-day year composed of twelve, 30-day months.

### Conversion of Notes

You may convert any of your notes, in whole or in part, into shares of our common stock prior to the close of business on the final maturity date of the notes, subject to prior redemption or repurchase of the notes, only under the following circumstances:

- upon satisfaction of a market price condition;
- upon satisfaction of a trading price condition;
- upon notice of redemption; or
- upon specified corporate transactions.

The number of shares of common stock you will receive upon conversion of your notes will be determined by multiplying the number of $1,000 principal amount notes you convert by the conversion rate on the date of conversion. You may convert your notes in part so long as such part is $1,000 principal amount or an integral multiple of $1,000.

If we call notes for redemption, you may convert the notes only until the close of business on the business day immediately preceding the redemption date unless we fail to pay the redemption price. If you have submitted your notes for repurchase upon a fundamental change, you may convert your notes only if you withdraw your repurchase election. Similarly, if you exercise your option to require us to repurchase your notes other than upon a fundamental change, those notes may be converted only if you withdraw your election to exercise your option in accordance with the terms of the indenture. Upon conversion of a note, the holder will not receive any cash payment of interest (unless such conversion occurs between a regular record date and the interest payment date to which it relates). Our delivery to the holder of the full number of shares of our common stock into which the note is convertible, together with any cash payment for such holder s fractional shares will be deemed to satisfy our obligation to pay:

- the principal amount of the note; and
- accrued but unpaid interest attributable to the period from the most recent interest payment date to the conversion date.

As a result, accrued but unpaid interest to the conversion date is deemed to be paid in full rather than cancelled, extinguished or forfeited.

Notwithstanding the preceding paragraph, if notes are converted after a record date but prior to the next succeeding interest payment date, holders of such notes at the close of business on the record date will receive the interest payable on such notes on the corresponding interest payment date notwithstanding the conversion. Such notes, upon surrender for conversion, must be accompanied by funds equal to the amount of interest payable on the notes so converted; provided that no such payment need be made if (1) we have specified a redemption date that is after a record date and prior to the next interest payment date, (2) we have specified a purchase date following a fundamental change that is during such period or (3) only to the extent of overdue interest, any overdue interest exists at the time of conversion with respect to such note.

#### *Conversion Upon Satisfaction of Market Price Condition*

You may surrender your note for conversion into our common stock prior to close of business on the maturity date during any fiscal quarter if the closing sale price of our common stock exceeds 120% of the conversion price for at least 20 trading days in the 30 consecutive trading days ending on the last trading day of the preceding fiscal quarter.

The closing sale price of our common stock on any date means the closing per share sale price (or if no closing sale price is reported, the average of the bid and ask prices or, if more than one in either case, the average of the average bid and the average ask prices) on such date as reported in composite transactions for the principal United

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States securities exchange on which our common stock is traded or, if our common stock is not listed on a United States national or regional securities exchange, as reported by the Nasdaq System or by the National Quotation Bureau Incorporated. The conversion price as of any day will equal $1,000 divided by the number of shares of common stock issuable upon a conversion of a note.

***Conversion Upon Satisfaction of Trading Price Condition***

You may surrender your notes for conversion into our common stock prior to maturity during the five business day period after any five consecutive trading day period in which the trading price per $1,000 principal amount of notes, as determined following a request by a holder of notes in accordance with the procedures described below, for each day of that period was less than 98% of the product of the closing sale price of our common stock and the conversion rate; *provided*, however, you may not convert your notes in reliance on this provision after December 31, 2028 if on any trading day during such measurement period the closing sale price of our common stock was between 100% and 120% of the then current conversion price of the notes.

The trading price of the notes on any date of determination means the average of the secondary market bid quotations obtained by the trustee for $10 million principal amount of the notes at approximately 3:30 p.m., New York City time, on such determination date from three independent nationally recognized securities dealers we select; *provided* that if three such bids cannot reasonably be obtained by the trustee, but two such bids are obtained, then the average of the two bids shall be used, and if only one such bid can reasonably be obtained by the trustee, that one bid shall be used. If the trustee cannot reasonably obtain at least one bid for $10 million principal amount of the notes from a nationally recognized securities dealer then the trading price per $1,000 principal amount of notes will be deemed to be less than 98% of the product of the closing sale price of our common stock and the conversion rate.

In connection with any conversion upon satisfaction of the above trading price condition, the trustee shall have no obligation to determine the trading price of the notes unless we have requested such determination; and we shall have no obligation to make such request unless you provide us with reasonable evidence that the trading price per $1,000 principal amount of notes would be less than 98% of the product of the closing sale price of our common stock and the number of shares of common stock issuable upon conversion of $1,000 principal amount of the notes. At such time, we shall instruct the trustee in writing to determine the trading price of the notes beginning on the next trading day and on each successive trading day until the trading price per $1,000 principal amount of notes is greater than or equal to 98% of the product of the closing sale price of our common stock and the conversion rate.

***Conversion Upon Notice of Redemption***

If we call notes for redemption, you may convert the notes until the close of business on the business day immediately preceding the redemption date, after which time your right to convert will expire unless we default in the payment of the redemption price.

Conversion Upon Specified Corporate Transactions

If we elect to:

distribute to all holders of our common stock certain rights entitling them to purchase, for a period expiring within 45 days of the record date for such distribution, our common stock at less than the current market price (measured by averaging the closing prices of our common stock for the 10 trading days preceding the declaration date of such distribution); or distribute to all holders of our common stock, assets, debt securities or certain rights to purchase our securities, which distribution has a per share value exceeding 5% of the closing sale price of our common stock on the day preceding the declaration date for such distribution;

we must notify you at least 20 days prior to the ex-dividend date for such distribution. Once we have given such notice, you may surrender your notes for conversion at any time until the earlier of close of business on the business day prior to the ex-dividend date or any announcement by us that such distribution will not take place. No adjustment to your ability to convert will be made if you will otherwise participate in the distribution without conversion.

In addition, if we are a party to a consolidation, merger, binding share exchange or sale of all or substantially all of our assets, in each case pursuant to which our common stock would be converted into cash, securities or other property, you may surrender your notes for conversion at any time from and after the date which is 15 days prior to the anticipated effective date of the transaction until and including the date which is 15 days after the actual date of such transaction. If we are a party to a consolidation, merger, binding share exchange or sale of all or substantially all of our assets, in each case pursuant to which our common stock is converted into cash, securities, or other property, then at the effective time of the transaction, your right to convert a note into our common stock will be changed into a right to convert it into the kind and amount of cash, securities and other property which you would have received if you had converted your notes immediately prior to the transaction. If the transaction also constitutes a fundamental change, you can require us to redeem all or a portion of your notes as described under Repurchase at Option of the Holder Upon a Fundamental Change.

***Conversion Procedures***

The initial conversion rate for the notes is 44.7193 shares of common stock per $1,000 principal amount of notes, subject to adjustment as described below. We will not issue fractional shares of common stock upon conversion of notes. Instead, we will pay cash equal to the closing price of the common stock on the trading day prior to the conversion date. Except as described below, you will not receive any accrued interest or dividends upon conversion.

To convert your note into common stock you must:

- complete and manually sign the conversion notice on the back of the note or facsimile of the conversion notice and deliver this notice to the conversion agent;
- surrender the note to the conversion agent;
- if required, furnish appropriate endorsements and transfer documents;
- if required, pay all transfer or similar taxes; and
- if required, pay funds equal to interest payable on the next interest payment date.

The date you comply with these requirements is the conversion date under the indenture. If your interest is a beneficial interest in a global note, to convert you must comply with the last three requirements listed above and comply with DTC s procedures for converting a beneficial interest in a global note.

We will adjust the conversion rate if any of the following events occurs:

- we issue common stock as a dividend or distribution on our common stock;
- we issue to all holders of common stock certain rights or warrants to purchase our common stock at less than the then current market price of our common stock; provided, however, that if such rights, options or warrants are only exercisable upon the occurrence of certain triggering events, then the conversion price will not be adjusted until such triggering events occur;
- we subdivide or combine our common stock;

we distribute to all holders of our common stock, shares of our capital stock, evidences of indebtedness or assets, including cash or securities but excluding:

rights or warrants specified above;

dividends or distributions specified above.

If we distribute capital stock of, or similar equity interests in, a subsidiary or other business unit of ours, the conversion rate will be adjusted based on the market value of the securities so distributed relative to the market value of our common stock, in each case based on the average closing sales prices of those securities for the 10 trading days commencing on and including the fifth trading day after the date on which ex-dividend trading commences for such distribution on the New York Stock Exchange or such other national or regional exchange or market on which the securities are then listed or quoted.

If we distribute cash, then the conversion rate shall be increased so that it equals the rate determined by multiplying the conversion rate in effect on the record date with respect to the cash distribution by a fraction, (1) the numerator of which shall be the current market price of a share of our common stock on the record date, and (2) the denominator of which shall be the same price of a share on the record date less the amount of the distribution. Current market price shall mean the average of the daily closing sale prices per share of common stock for the ten consecutive trading days ending on the earlier of the date of determination and the day before the ex date with respect to the distribution requiring such computation. For purpose of this paragraph, the term ex date, when used with respect to any distribution, means the first date on which the common stock trades, regular way, on the relevant exchange or in the relevant market from which the closing sale price was obtained without the right to receive such distribution.

we or one of our subsidiaries makes a payment in respect of a tender offer or exchange offer for our common stock to the extent that the cash and value of any other consideration included in the payment per share of common stock exceeds the current market price per share of common stock on the trading day next succeeding the last date on which tenders or exchanges may be made pursuant to such tender or exchange offer; and

someone other than us or one of our subsidiaries makes a payment in respect of a tender offer or exchange offer in which, as of the closing date of the offer, our board of directors is not recommending rejection of the offer. The adjustment referred to in this clause will only be made if:

the tender offer or exchange offer is for an amount that increases the offeror s ownership of common stock to more than 25% of the total shares of common stock outstanding; and

the cash and value of any other consideration included in the payment per share of common stock exceeds the current market price per share of common stock on the business day next succeeding the last date on which tenders or exchanges may be made pursuant to the tender or exchange offer.

However, the adjustment referred to in this clause will generally not be made if as of the closing of the offer, the offering documents disclose a plan or an intention to cause us to engage in a consolidation or merger or a sale of all or substantially all of our assets.

To the extent that we have a rights plan in effect upon conversion of the notes into common stock, you will receive, in addition to the common stock, the rights under the rights plan unless the rights have separated from the common stock at the time of conversion, in which case the conversion rate will be adjusted as if we distributed to all holders of our common stock, shares of our capital stock, evidences of indebtedness or assets as described above, subject to readjustment in the event of the expiration, termination or redemption of such rights; provided, however that any holder who is a holder of shares of our common stock (or direct or indirect interests therein) at the time of conversion of any note, but who is not entitled as a holder of our common stock to hold or receive rights pursuant to the terms of the shareholder rights plan, shall not be eligible to receive any such rights thereunder.

In the event of:

any reclassification of our common stock;

a consolidation, merger or combination involving us; or

a sale or conveyance to another person or entity of all or substantially all of our property and assets;
in which holders of our common stock would be entitled to receive stock, other securities, other property, assets or cash for their common stock, upon conversion of your notes you will be entitled to receive the same type of consideration which you would have been entitled to receive if you had converted the notes into our common stock immediately prior to any of these events.

You may in certain situations be deemed to have received a distribution subject to United States federal income tax as a dividend in the event of any taxable distribution to holders of common stock or in certain other situations requiring a conversion rate adjustment. See United States Federal Tax Considerations.

We may, from time to time, increase the conversion rate if our board of directors has made a determination that this increase would be in our best interests. Any such determination by our board will be conclusive. In addition, we may increase the conversion rate if our board of directors deems it advisable to avoid or diminish any income tax to holders of common stock resulting from any stock or rights distribution. See United States Federal Tax Considerations.

We will not be required to make an adjustment in the conversion rate unless the adjustment would require a change of at least 1% in the conversion rate. However, we will carry forward any adjustments that are less than 1% of the conversion rate. Except as described above in this section, we will not adjust the conversion rate for any issuance of our common stock or convertible or exchangeable securities or rights to purchase our common stock or convertible or exchangeable securities.

**Optional Redemption by AGCO**

Beginning January 1, 2011, we may redeem the notes in whole or in part for an amount in cash equal to 100% of the principal amount plus interest to, but excluding, the redemption date. If the redemption date is an interest payment date, interest shall be paid to the record holder on the relevant record date. We are required to give notice of redemption by mail to holders not more than 60 but not less than 30 days prior to the redemption date.

If less than all of the outstanding notes are to be redeemed, the trustee will select the notes to be redeemed in principal amounts of $1,000 or multiples of $1,000 by lot, pro rata or by another method the trustee considers fair and appropriate. If a portion of your notes is selected for partial redemption and you convert a portion of your notes, the converted portion will be deemed to be of the portion selected for redemption.

We may not redeem the notes if we have failed to pay any interest on the notes and such failure to pay is continuing. We will notify the noteholders if we redeem the notes.

**Repurchase at Option of the Holder**

You have the right to require us to repurchase the notes for cash on December 31 of 2010, 2013, 2018, 2023 and 2028. We will be required to repurchase any outstanding note for which you deliver a written repurchase notice to the paying agent. This notice must be delivered during the period beginning at any time from the opening of business on the date that is 20 business days prior to the repurchase date until the close of business on the repurchase date. If a repurchase notice is given and withdrawn during that period, we will not be obligated to repurchase the notes listed in the notice. Our repurchase obligation will be subject to certain additional conditions.

The repurchase price payable for a note will be equal to 100% of the principal amount, plus interest to, but excluding, the repurchase date.

Your right to require us to repurchase notes is exercisable by delivering a written repurchase notice to the paying agent within 20 business days of the repurchase date. The paying agent initially will be the trustee.

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The repurchase notice must state:

(1) if certificated notes have been issued, the note certificate numbers (or, if your notes are not certificated, your repurchase notice must comply with appropriate DTC procedures);

(2) the portion of the principal amount of notes to be repurchased, which must be in $1,000 multiples; and

(3) that the notes are to be repurchased by us pursuant to the applicable provisions of the notes and the indenture.

You may withdraw any written repurchase notice by delivering a written notice of withdrawal to the paying agent prior to the close of business of the repurchase date. The withdrawal notice must state:

the principal amount of the withdrawn notes;

if certificated notes have been issued, the certificate numbers of the withdrawn notes (or, if your notes are not certificated, your withdrawal notice must comply with appropriate DTC procedures); and

the principal amount, if any, which remains subject to the repurchase notice.

We must give notice of an upcoming repurchase date to all note holders not less than 20 business days prior to the repurchase date at their addresses shown in the register of the registrar. We will also give notice to beneficial owners as required by applicable law. This notice will state, among other things, the procedures that holders must follow to require us to repurchase their notes.

Payment of the repurchase price for a note for which a repurchase notice has been delivered and not withdrawn is conditioned upon book-entry transfer or delivery of the note, together with necessary endorsements, to the paying agent at its office in the Borough of Manhattan, The City of New York, or any other office of the paying agent, at any time after delivery of the repurchase notice. Payment of the repurchase price for the note will be made promptly following the later of the repurchase date and the time of book-entry transfer or delivery of the note. If the paying agent holds money sufficient to pay the repurchase price of the note on the business day following the repurchase date, then, on and after the date:

the note will cease to be outstanding;

interest will cease to accrue; and

all other rights of the holder will terminate, other than the right to receive the repurchase price upon delivery of the note.

This will be the case whether or not book-entry transfer of the note has been made or the note has been delivered to the paying agent.

Our ability to repurchase notes with cash may be limited by the terms of our then-existing borrowing agreements. Even though we become obligated to repurchase any outstanding note on a repurchase date, we may not have sufficient funds to pay the repurchase price on that repurchase date.

We will comply with the provisions of Rule 13e-4 and any other rules under the Exchange Act that may be applicable.

**Repurchase at Option of the Holder Upon a Fundamental Change**

If a fundamental change of AGCO occurs at any time prior to the maturity of the notes, you may require us to repurchase your notes, in whole or in part, on a repurchase date that is 30 days after the date of our notice of the fundamental change. The notes will be repurchased in integral multiples of $1,000 principal amount. We will

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repurchase the notes at a price equal to 100% of the principal amount to be repurchased, plus accrued interest to, but excluding, the repurchase date.

We will mail to all record holders a notice of a fundamental change within 10 days after it has occurred. We are also required to deliver to the trustee a copy of the fundamental change notice. If you elect to require us to repurchase your notes, you must deliver to us or our designated agent, on or before the 30th day after the date of our fundamental change notice, your repurchase notice for transfer. We will promptly pay the repurchase price for notes surrendered for repurchase following the later of the redemption date and the time of book-entry transfer or delivery of the notes to be redeemed, duly endorsed for transfer. If the paying agent holds money sufficient to pay the repurchase price for any note on the business day following the redemption date, then, on and after such date, the notes will cease to be outstanding, interest will cease to accrue and all other rights of the holder will terminate, except the right to receive the repurchase price. This will be the case whether or not book-entry transfer of the note has been made or the note has been delivered to the paying agent.

You may withdraw any written repurchase notice by delivering a written notice of withdrawal to the paying agent prior to the close of business on the repurchase date. The withdrawal notice must state:

the principal amount of the withdrawn notes;

if certificated notes have been issued, the certificate numbers of the withdrawn notes (or, if your notes are not certificated, your withdrawal notice must comply with appropriate DTC procedures); and

the principal amount, if any, that remains subject to the repurchase notice.

A fundamental change is any transaction or event (whether by means of an exchange offer, liquidation, tender offer, consolidation, merger, combination, reclassification, recapitalization or otherwise) in connection with which all or substantially all of our common stock is exchanged for, converted into, acquired for or constitutes solely the right to receive, consideration which is not all or substantially all common stock that:

is listed on, or immediately after the transaction or event will be listed on, a United States national securities exchange, or

is approved, or immediately after the transaction or event will be approved, for quotation on the NASDAQ National Market or any similar United States system of automated dissemination of quotations of securities prices.

We will comply with any applicable provisions of Rule 13e-4 and any other tender offer rules under the Exchange Act in the event of a fundamental change.

These fundamental change repurchase rights could discourage a potential acquirer. However, this fundamental change repurchase feature is not the result of management s knowledge of any specific effort to obtain control of us by means of a merger, tender offer or solicitation, or part of a plan by management to adopt a series of anti-takeover provisions. The term fundamental change is limited to specified transactions and may not include other events that might adversely affect our financial condition or business operations. Our obligation to offer to repurchase the notes upon a fundamental change would not necessarily afford you protection in the event of a highly leveraged transaction, reorganization, merger or similar transaction involving us.

We may be unable to repurchase the notes in the event of a fundamental change. If a fundamental change were to occur, we may not have enough funds to pay the repurchase price for all tendered notes. Any future credit agreements or other agreements relating to our indebtedness may contain provisions prohibiting repurchase of the notes under certain circumstances, or expressly prohibit our repurchase of the notes upon a fundamental change or may provide that a fundamental change constitutes an event of default under that agreement. If a fundamental change occurs at a time when we are prohibited from repurchasing notes, we could seek the consent of our lenders to repurchase the notes or attempt to refinance this debt. If we do not obtain consent, we would not be permitted to repurchase the notes. Our failure to repurchase tendered notes would constitute an event of default under the indenture, which might constitute a default under the terms of our other indebtedness. In these circumstances, or if a fundamental change would constitute an event of default under our senior indebtedness, the subordination provisions of the indenture would restrict payments to the holders of notes.

**Subordination of Notes**

Payment on the notes will, to the extent provided in the indenture, be subordinated in right of payment to the prior payment in full of all of our senior indebtedness. The notes will be pari passu in right of payment with the Company s 6 7/8% Senior Subordinated Notes due 2014. The notes also are effectively subordinated to all debt and other liabilities, including trade payables and lease obligations, if any, of our subsidiaries.

Upon any distribution of our assets upon any dissolution, winding up, liquidation or reorganization, the payment of the principal of, or premium, if any, interest, and liquidated damages, if any, on the notes will be subordinated in right of payment to the prior payment in full in cash or other payment satisfactory to the holders of senior indebtedness of all senior indebtedness. In the event of any acceleration of the notes because of an event of default, the holders of any outstanding senior indebtedness would be entitled to payment in full in cash or other payment satisfactory to the holders of senior indebtedness of all senior indebtedness obligations before the holders of the notes are entitled to receive any payment or distribution. So long as the bank credit agreement is in effect, any declaration of acceleration of the notes will not become effective until the earlier of (1) five business days after receipt of acceleration notice by us and the administrative agent under the bank credit agreement and (2) the acceleration of the indebtedness under the bank credit agreement.

We may not make any payment on the notes if:

a default in the payment of senior indebtedness occurs and such default has not been cured or waived (called a payment default ); or

a default other than a payment default (1) under the bank credit agreement occurs and is continuing pursuant to which the maturity thereof may be accelerated and (a) upon receipt by the trustee of written notice of such default (called a payment blockage notice ) from the administrative agent under the bank credit agreement or (b) if such event of default under the bank credit agreement results from the acceleration of the notes or a change of control, from and after the date of such acceleration or occurrence of such change of control or (2) under any other designated senior indebtedness other than the bank credit agreement that permits the holders of such designated senior indebtedness to accelerate its maturity, and the trustee receives a payment blockage notice from the trustee or other representative of the holders of such designated senior indebtedness (called a non-payment default ).

We may resume payments and distributions on the notes:

in case of a payment default, upon the date on which such default is cured or waived; and

in case of a non-payment default, (1) if such non-payment default exists under the bank credit agreements, 179 days after the date on which the payment blockage notice is received (unless such payment blockage period is terminated by written notice to the trustee from administrative agent, such designated senior indebtedness is repaid in full in cash or cash equivalents or such event of default has been cured or waived), or (2) if such non-payment default exists under designated senior indebtedness other than the bank credit agreement, 119 days after the date on which the payment blockage notice is received (unless such payment blockage period is terminated by written notice to the trustee from the trustee or other representative of the holders of such designated senior indebtedness, such designated senior indebtedness is repaid in full in cash or cash equivalents or such event of default has been cured or waived).

There must be 180 consecutive days in any 360-day period in which no payment blockage is in effect for a non-payment default. No non-payment default (other than a non-payment default under the financial maintenance covenants under the bank credit agreement) that existed or was continuing on the date of delivery of any payment blockage notice shall be the basis for any later payment blockage notice unless such non-payment default has been cured or waived for a period of not less than 45 days.

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If the trustee or any holder of the notes receives any payment or distribution of our assets in contravention of the subordination provisions on the notes before all senior indebtedness is paid in full in cash or other payment satisfactory to holders of senior indebtedness, then trustee will notify the holders of such senior indebtedness of such prohibited payment and such payment or distribution will be held in trust for the benefit of, and shall be paid over and delivered to, holders of senior indebtedness or their representatives but only to the extent the holders of such senior indebtedness, within 30 days of the date of receipt of such notice from the trustee, notify the trustee in writing of the amounts then due and owing on such senior indebtedness and only the amounts specified in such notice to the trustee shall be paid.

Because of the subordination provisions discussed above, in the event of our bankruptcy, dissolution or reorganization, holders of senior indebtedness may receive more, ratably, and holders of the notes may receive less, ratably, than our other creditors. This subordination will not prevent the occurrence of any event of default under the indenture.

The notes are exclusively obligations of us. A substantial portion of our operations are conducted through our subsidiaries. As a result, our cash flow and our ability to service our debt, including the notes, is dependent upon the earnings of our subsidiaries. In addition, we are dependent on the distribution of earnings, loans or other payments from our subsidiaries. In addition, any payment of dividends, distributions, loans or advances by our subsidiaries to us could be subject to statutory or contractual restrictions. Payments to us by our subsidiaries will also be contingent upon our subsidiaries earnings and business considerations.

Our right to receive any assets of any of our subsidiaries upon their liquidation or reorganization, and therefore the right of the holders to participate in those assets, will be effectively subordinated to the claims of that subsidiary s creditors, including trade creditors. In addition, even if we were a creditor to any of our subsidiaries, our rights as a creditor would be subordinate to any security interest in the assets of our subsidiaries and any indebtedness of our subsidiaries senior to that held by us.

The term senior indebtedness is defined in the indenture and includes principal, premium, interest, rent, fees, costs, expenses and other amounts accrued or due on our existing or future indebtedness, as defined below, or any existing or future indebtedness guaranteed or in effect guaranteed by us, subject to certain exceptions. The term does not include:

any indebtedness that when incurred was without recourse to us; or

any indebtedness that by its express terms is not senior to the notes or is pari passu or junior to the notes; or

any indebtedness we owe to any of our subsidiaries or to a joint venture in which we have an interest; or

any repurchase, redemption or other obligations in respect of redeemable stock; or

any indebtedness to any of our employees, officers or directors or any employees, officers or director of our subsidiaries; or

any liability for federal, state, local or other taxes owed or owing by the company; or

our 6-7/8% Senior Subordinated Notes due 2014; or

any trade payables; or

the notes.

The term indebtedness is also defined in the indenture and includes, in general terms, our liabilities in respect of borrowed money, notes, bonds, debentures, letters of credit, bank guarantees, bankers acceptances, capital and certain other leases, interest rate and foreign currency derivative contracts or similar arrangements, guarantees and certain other obligations described in the indenture, subject to certain exceptions. The term does not include, for

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example, any account payable or other accrued current liability or obligation incurred in the ordinary course of business in connection with the obtaining of materials or services.

The term bank credit agreement is defined in the indenture and means the credit agreement dated April 17, 2001, as amended, among AGCO, certain of its subsidiaries named therein, the lenders named therein, Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A., Rabobank Nederland, New York Branch ( Rabobank ), SunTrust Bank and Credit Suisse First Boston, as Co-Syndication Agents; Rabobank, Cobank, ACB and Bear Stearns Corporate Lending, Inc., as Co-Documentation Agents; Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A., Rabobank Nederland, Canadian Branch, as Canadian administrative agent, and Rabobank as administrative agent, together with all agreements, instruments and documents executed or delivered pursuant thereto or in connection therewith, in each case as such agreements, documents or instruments may be amended, supplemented, extended, renewed, replaced or otherwise modified from time to time, including, but not limited by, the credit agreement and other documents executed in connection with the credit facility contemplated by that certain commitment letter dated August 15, 2003 from Rabobank to the Company.

The term designated senior indebtedness is defined in the indenture and includes, in general terms, indebtedness and all other monetary obligations, including expenses, fees and other amounts under the bank credit agreement and any senior indebtedness that has an aggregate principal balance of at least $25 million that is specifically designated by AGCO in the instrument creating or evidencing such senior indebtedness as designated senior indebtedness.

As of June 30, 2004, we had $544.2 million of senior indebtedness outstanding and our subsidiaries had $304.6 million of indebtedness. Neither we nor our subsidiaries are prohibited from incurring debt, including senior indebtedness, under the indenture. We may from time to time incur additional debt, including senior indebtedness. Our subsidiaries may also from time to time incur additional debt and liabilities.

We are obligated to pay reasonable compensation to the trustee and to indemnify the trustee against certain losses, liabilities or expenses incurred by the trustee in connection with its duties relating to the notes. The trustee s claims for these payments will generally be senior to those of noteholders in respect of all funds collected or held by the trustee.

**Merger and Sale of Assets by AGCO**

The indenture provides that we may not consolidate with or merge with or into any other person or convey, transfer or lease our properties and assets substantially as an entirety to another person, unless among other items:

- we are the surviving person, or the resulting, surviving or transferee person, if other than us is organized and existing under the laws of the United States or any jurisdiction thereof;
- the successor person expressly assumes all of our obligations under the notes and the indenture; and
- we or such successor person will not be in default under the indenture immediately after the transaction.

When such a person assumes our obligations in such circumstances, subject to certain exceptions and the satisfaction of other conditions under the indenture, we shall be discharged from all ew Roman; font-size:10pt">

Loss on sale of foreclosed real estate

183 356

Adjustment of carrying value of foreclosed real estate

957 149

Accretion of bond premiums/discounts

780 692

Amortization of core deposit intangible

8 36

Net change in:

Interest receivable

264 153

Other assets

118 212

Accrued interest payable

297 298

Accrued expenses and other liabilities

784 806

Net Cash Provided by Operating Activities

4,922 6,327

**CASH FLOWS FROM INVESTING ACTIVITIES**

| | | |
|---|---|---|
| Net decrease in loans | 22,558 | 13,115 |
| Proceeds from sale of loans | 2,905 | |
| Purchase of securities available-for-sale | (43,534) | (36,894) |
| Proceeds from sale and maturities of securities available-for-sale | 25,642 | 12,831 |
| Sale of Federal Home Loan Bank stock | 350 | 309 |
| Purchase of Federal Reserve Bank stock | | (210) |
| Payments for the purchase of premises and equipment | (1,426) | (1,191) |
| Proceeds from sales of premises and equipment | 553 | 389 |
| Proceeds from sales of other real estate owned | 2,164 | 4,376 |

| | | |
|---|---|---|
| Net Cash Provided by (Used In) Investing Activities | 9,212 | (7,275) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Exercise of common stock warrants | | 14 |
| Stock offering costs | | (37) |
| Repayments to Federal Home Loan Bank | (900) | (900) |
| Net change in: | | |
| Demand deposits | 8,547 | 3,223 |
| Savings deposits | 8,156 | (12,387) |
| Time deposits | | |

(32,853) (19,506)

Net Cash Used in Financing Activities

(17,050) (29,593)

Net decrease in cash and cash equivalents

(2,916) (30,541)

Cash and Cash Equivalents, Beginning of Period

54,680 94,109

Cash and Cash Equivalents, End of Period

$51,764 $63,568

Supplemental Disclosure of Cash Paid During the Period for:

Interest

$2,759 $3,327

Taxes

$ $

Supplemental Disclosure of Non Cash Transactions:

Other real estate acquired in settlement of foreclosed loans

$2,224 $5,366

Loans made to finance sale of foreclosed real estate

$1,232 $245

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:

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. ( 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. In June 2012 the name of NPB Financial Services, Inc. was changed to NPB Insurance Services, Inc. which operates solely as an insurance agency.

## NOTE 2 ACCOUNTING PRINCIPLES:

These consolidated financial statements conform to U. S. generally accepted accounting principles and to general industry practices. In the opinion of management, the accompanying consolidated financial statements contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the Company s financial position at September 30, 2014, and the results of operations for the three and nine month periods ended September 30, 2014 and 2013. The notes included herein should be read in conjunction with the notes to the consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2013. The results of operations for the three and nine month periods ended September 30, 2014 and 2013 are not necessarily indicative of the results to be expected for the full year.

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 and the determination of the deferred tax asset and valuation allowance are based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions.

## 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 September 30, 2014, 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.

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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.

**NOTE 4 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 September 30, 2014, the Company and the Bank meet all capital adequacy requirements to which they are subject.

As of September 30, 2014, 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 following table as of September 30, 2014 and December 31, 2013, respectively.

| | Actual | Minimum Capital Requirement | Minimum to Be Well Capitalized Under Prompt Corrective Action |
|---|---|---|---|

| (Dollars are in thousands) | Amount | Ratio | Amount | Ratio | Provisions Amount | Ratio |
|---|---|---|---|---|---|---|
| September 30, 2014: | | | | | | |
| Total Capital to Risk Weighted Assets: | | | | | | |
| The Company | $ 58,044 | 15.26% | $ 30,438 | 8% | $ N/A | N/A |
| The Bank | 57,379 | 15.09% | 30,418 | 8% | 38,023 | 10% |
| Tier 1 Capital to Risk Weighted Assets: | | | | | | |
| The Company | 50,913 | 13.38% | 15,219 | 4% | N/A | N/A |
| The Bank | 52,556 | 13.82% | 15,209 | 4% | 22,814 | 6% |
| Tier 1 Capital to Average Assets: | | | | | | |
| The Company | 50,913 | 7.57% | 26,894 | 4% | N/A | N/A |
| The Bank | 52,556 | 7.81% | 26,907 | 4% | 33,633 | 5% |
| December 31, 2013: | | | | | | |
| Total Capital to Risk Weighted Assets: | | | | | | |
| The Company | $ 58,305 | 14.39% | $ 32,417 | 8% | $ N/A | N/A |
| The Bank | 56,602 | 13.96% | 32,430 | 8% | 40,538 | 10% |
| Tier 1 Capital to Risk Weighted Assets: | | | | | | |
| The Company | 50,776 | 12.53% | 16,208 | 4% | N/A | N/A |
| The Bank | 51,436 | 12.69% | 16,215 | 4% | 24,323 | 6% |
| Tier 1 Capital to Average Assets: | | | | | | |
| The Company | 50,776 | 7.40% | 27,445 | 4% | N/A | N/A |
| The Bank | 51,436 | 7.49% | 27,460 | 4% | 34,326 | 5% |

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**NOTE 5 INVESTMENT SECURITIES:**

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

| (Dollars are in thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Approximate Fair Value |
|---|---|---|---|---|
| September 30, 2014 | | | | |
| U.S. Government Agencies | $ 40,889 | $ 217 | $ 461 | $ 40,645 |
| Taxable municipals | 296 | | 8 | 288 |
| Tax-exempt municipals | | | | |
| Mortgage backed securities | 56,510 | 103 | 483 | 56,130 |
| Total Securities AFS | $ 97,695 | $ 320 | $ 952 | $ 97,063 |
| December 31, 2013 | | | | |
| U.S. Government Agencies | $ 39,296 | $ 246 | $ 941 | $ 38,601 |
| Taxable municipals | | | | |
| Tax-exempt municipals | | | | |
| Mortgage backed securities | 41,284 | 60 | 819 | 40,525 |
| Total Securities AFS | $ 80,580 | $ 306 | $ 1,760 | $ 79,126 |

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 September 30, 2014 and December 31, 2013.

| | Less than 12 Months | | 12 Months or More | | Total | |
|---|---|---|---|---|---|---|
| (Dollars are in thousands) | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| September 30, 2014 | | | | | | |
| U.S. Government Agencies | $ 10,164 | $ 42 | $ 13,258 | $ 419 | $ 23,422 | $ 461 |
| Taxable municipals | 288 | 8 | | | 288 | 8 |
| Mtg. backed securities | 24,840 | 194 | 16,190 | 289 | 41,030 | 483 |
| Total Securities AFS | $ 35,292 | $ 244 | $ 29,448 | $ 708 | $ 64,740 | $ 952 |
| December 31, 2013 | | | | | | |
| U.S. Government Agencies | $ 26,090 | $ 936 | $ 570 | $ 5 | $ 26,660 | $ 941 |
| Mtg. backed securities | 27,461 | 693 | 5,046 | 126 | 32,507 | 819 |
| Total Securities AFS | $ 53,551 | $ 1,629 | $ 5,616 | $ 131 | $ 59,167 | $ 1,760 |

At September 30, 2014, the available-for-sale portfolio included ninety six investments for which the fair market value was less than amortized cost. At December 31, 2013, the available-for-sale portfolio included eighty 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. Based on the Company s analysis, the Company concluded that no securities had an other than temporary impairment.

The amortized cost and fair value of investment securities at September 30, 2014, 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)**<br>**Securities Available-for-Sale** | **Amortized Cost** | **Fair Value** | **Weighted Average Yield** |
|---|---|---|---|
| Due in one year or less | $ 48 | $ 49 | 2.27% |
| Due after one year through five years | 2,419 | 2,422 | 1.27% |
| Due after five years through fifteen years | 36,133 | 36,042 | 1.70% |
| Due after fifteen years | 59,095 | 58,550 | 1.86% |
| Total | $ 97,695 | $ 97,063 | 1.79% |

Investment securities with a carrying value of $18.4 million and $17.0 million at September 30, 2014 and December 31, 2013, 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 $2.4 million and $2.7 million as of September 30, 2014 and December 31, 2013, respectively.

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**NOTE 6 LOANS:**

Loans receivable outstanding are summarized as follows:

| (Dollars are in thousands) | September 30, 2014 | December 31, 2013 |
|---|---|---|
| Real estate secured: | | |
| Commercial | $ 113,765 | $ 126,174 |
| Construction and land development | 15,273 | 22,421 |
| Residential 1-4 family | 246,465 | 249,187 |
| Multifamily | 11,684 | 11,482 |
| Farmland | 25,783 | 28,892 |
| Total real estate loans | 412,970 | 438,156 |
| Commercial | 20,898 | 24,955 |
| Agriculture | 3,408 | 3,718 |
| Consumer installment loans | 26,558 | 26,055 |
| All other loans | 108 | 139 |
| Total loans | $ 463,942 | $ 493,023 |

Loans receivable on nonaccrual status are summarized as follows:

| (Dollars are in thousands) | September 30, 2014 | December 31, 2013 |
|---|---|---|
| Real estate secured: | | |
| Commercial | $ 9,598 | $ 16,098 |
| Construction and land development | 570 | 775 |
| Residential 1-4 family | 7,774 | 4,852 |
| Multifamily | 121 | 171 |
| Farmland | 5,335 | 5,315 |
| Total real estate loans | 23,398 | 27,211 |
| Commercial | 644 | 947 |
| Agriculture | 30 | 45 |
| Consumer installment loans | 44 | 104 |
| All other loans | | |
| Total loans receivable on nonaccrual status | $ 24,116 | $ 28,307 |

Total interest income not recognized on nonaccrual loans for the nine months ended September 30, 2014 and 2013 was $343 thousand and $375 thousand, respectively.

In the first nine months of 2014, two nonperforming loans totaling $3.2 million were sold to further reduce the high level of nonaccrual loans. A charge off of $474 thousand was realized which was fully absorbed by unallocated portion of the allowance for loan losses with no additional provisions needed. We will continue to evaluate certain loans to determine if additional loans may be sold at minimal impact to earnings and to capital levels in the near future as we aggressively work to reduce the level of nonperforming loans. There were no nonperforming loans sold during the first nine months of 2013.

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The following table presents information concerning the Company s investment in loans considered impaired as of September 30, 2014 and December 31, 2013:

| **As of September 30, 2014** (Dollars are in thousands) | Average Recorded Investment | Interest Income Recognized | Recorded Investment | Unpaid Principal Balance | Related Allowance |
|---|---|---|---|---|---|
| With no related allowance recorded: | | | | | |
| Real estate secured: | | | | | |
| Commercial | $ 11,038 | $ 140 | $ 8,246 | $ 9,569 | $ |
| Construction and land development | 306 | 8 | 379 | 379 | |
| Residential 1-4 family | 2,888 | 132 | 3,479 | 3,592 | |
| Multifamily | 354 | 20 | 442 | 483 | |
| Farmland | 5,288 | 100 | 6,209 | 7,012 | |
| Commercial | 390 | | 628 | 737 | |
| Agriculture | 65 | 3 | 61 | 66 | |
| Consumer installment loans | 11 | 1 | 17 | 17 | |
| All other loans | | | | | |
| With an allowance recorded: | | | | | |
| Real estate secured: | | | | | |
| Commercial | 6,794 | 76 | 3,962 | 4,325 | 991 |
| Construction and land development | 556 | 11 | 307 | 358 | 92 |
| Residential 1-4 family | 4,667 | 110 | 3,073 | 3,284 | 565 |
| Multifamily | 307 | 12 | 262 | 262 | 32 |
| Farmland | 2,940 | 45 | 1,179 | 1,190 | 396 |
| Commercial | 490 | 2 | 62 | 62 | 15 |
| Agriculture | 41 | 2 | 33 | 33 | 33 |
| Consumer installment loans | 12 | | | | |
| All other loans | | | | | |
| Total | $ 36,147 | $ 662 | $ 28,339 | $ 31,369 | $ 2,124 |

| **As of December 31, 2013** (Dollars are in thousands) | Average Recorded Investment | Interest Income Recognized | Recorded Investment | Unpaid Principal Balance | Related Allowance |
|---|---|---|---|---|---|
| With no related allowance recorded: | | | | | |
| Real estate secured: | | | | | |
| Commercial | $ 16,270 | $ 300 | $ 9,807 | $ 10,276 | $ |
| Construction and land development | 2,246 | 26 | 336 | 345 | |
| Residential 1-4 family | 4,276 | 126 | 2,557 | 2,727 | |
| Multifamily | 652 | 16 | 326 | 326 | |
| Farmland | 4,260 | 166 | 2,533 | 2,670 | |
| Commercial | 717 | 7 | 315 | 423 | |
| Agriculture | 71 | 6 | 60 | 60 | |
| Consumer installment loans | 51 | 2 | 12 | 12 | |
| All other loans | | | | | |
| With an allowance recorded: | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Real estate secured: | | | | | |
| Commercial | 12,080 | 441 | 12,092 | 13,924 | 1,942 |
| Construction and land development | 492 | 9 | 554 | 640 | 138 |
| Residential 1-4 family | 3,980 | 260 | 5,458 | 5,824 | 1,180 |
| Multifamily | 561 | 17 | 268 | 268 | 39 |
| Farmland | 4,116 | 114 | 6,109 | 6,797 | 653 |
| Commercial | 1,012 | 3 | 672 | 740 | 208 |
| Agriculture | 138 | 4 | 55 | 71 | 43 |
| Consumer installment loans | 22 | 2 | 22 | 22 | 3 |
| All other loans | | | | | |
| Total | $ 50,944 | $ 1,499 | $ 41,176 | $ 45,125 | $ 4,206 |

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

| As of September 30, 2014 (Dollars are in thousands) | Loans 30-59 Days Past Due | Loans 60-89 Days Past Due | Loans 90 or More Days Past Due | Total Past Due Loans | Current Loans | Total Loans | Accruing Loans 90 or More Days Past Due |
|---|---|---|---|---|---|---|---|
| Real estate secured: | | | | | | | |
| Commercial | $ 2,337 | $ 456 | $ 5,089 | $ 7,882 | $ 105,883 | $ 113,765 | $ |
| Construction and land development | 12 | | 243 | 255 | 15,018 | 15,273 | |
| Residential 1-4 family | 5,958 | 1,238 | 1,993 | 9,189 | 237,276 | 246,465 | |
| Multifamily | | | | | 11,684 | 11,684 | |
| Farmland | 1,101 | 30 | 375 | 1,506 | 24,277 | 25,783 | |
| Total real estate loans | 9,408 | 1,724 | 7,700 | 18,832 | 394,138 | 412,970 | |
| Commercial | 41 | 27 | 160 | 228 | 20,670 | 20,898 | |
| Agriculture | | | 17 | 17 | 3,391 | 3,408 | |
| Consumer installment Loans | 146 | 16 | | 162 | 26,396 | 26,558 | |
| All other loans | 13 | 4 | | 17 | 91 | 108 | |
| Total loans | $ 9,608 | $ 1,771 | $ 7,877 | $ 19,256 | $ 444,686 | $ 463,942 | $ |

| As of December 31, 2013 (Dollars are in thousands) | Loans 30-59 Days Past Due | Loans 60-89 Days Past Due | Loans 90 or More Days Past Due | Total Past Due Loans | Current Loans | Total Loans | Accruing Loans 90 or More Days Past Due |
|---|---|---|---|---|---|---|---|
| Real estate secured: | | | | | | | |
| Commercial | $ 7,192 | $ 1,713 | $ 4,174 | $ 13,079 | $ 113,095 | $ 126,174 | $ |
| Construction and land development | 505 | 183 | 347 | 1,035 | 21,386 | 22,421 | |
| Residential 1-4 family | 6,391 | 1,067 | 1,271 | 8,729 | 240,458 | 249,187 | |
| Multifamily | | 436 | | 436 | 11,046 | 11,482 | |
| Farmland | 1,869 | 137 | 3,986 | 5,992 | 22,900 | 28,892 | |
| Total real estate loans | 15,957 | 3,536 | 9,778 | 29,271 | 408,885 | 438,156 | |
| Commercial | 135 | 14 | 902 | 1,051 | 23,904 | 24,955 | |
| Agriculture | 26 | 20 | 13 | 59 | 3,659 | 3,718 | |
| Consumer installment Loans | 241 | 48 | 8 | 297 | 25,758 | 26,055 | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| All other loans | 11 | 7 | 1 | 19 | 120 | 139 | 1 |
| Total loans | $ 16,370 | $ 3,625 | $ 10,702 | $ 30,697 | $ 462,326 | $ 493,023 | $ 1 |

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:

**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 September 30, 2014**

| (Dollars are in thousands) | Pass | Special Mention | Substandard | Doubtful | Total |
|---|---|---|---|---|---|
| Real estate secured: | | | | | |
| Commercial | $ 94,542 | $ 8,117 | $ 11,106 | $ | $ 113,765 |
| Construction and land development | 12,355 | 2,078 | 840 | | 15,273 |
| Residential 1-4 family | 233,740 | 2,321 | 10,404 | | 246,465 |
| Multifamily | 11,221 | | 463 | | 11,684 |
| Farmland | 18,177 | 280 | 7,326 | | 25,783 |
| Total real estate loans | 370,035 | 12,796 | 30,139 | | 412,970 |
| Commercial | 17,210 | 2,794 | 894 | | 20,898 |
| Agriculture | 3,328 | | 80 | | 3,408 |
| Consumer installment loans | 26,447 | | 111 | | 26,558 |
| All other loans | 108 | | | | 108 |
| Total | $ 417,128 | $ 15,590 | $ 31,224 | $ | $ 463,942 |

**As of December 31, 2013**

| (Dollars are in thousands) | Pass | Special Mention | Substandard | Doubtful | Total |
|---|---|---|---|---|---|
| Real estate secured: | | | | | |
| Commercial | $ 100,403 | $ 4,586 | $ 21,185 | $ | $ 126,174 |
| Construction and land development | 19,138 | 2,107 | 1,176 | | 22,421 |
| Residential 1-4 family | 234,857 | 1,916 | 12,213 | 201 | 249,187 |
| Multifamily | 10,777 | 266 | 439 | | 11,482 |
| Farmland | 19,935 | 411 | 8,546 | | 28,892 |
| Total real estate loans | 385,110 | 9,286 | 43,559 | 201 | 438,156 |
| Commercial | 23,258 | 634 | 1,034 | 29 | 24,955 |
| Agriculture | 3,583 | 11 | 124 | | 3,718 |
| Consumer installment loans | 25,879 | | 176 | | 26,055 |
| All other loans | 139 | | | | 139 |
| Total | $ 437,969 | $ 9,931 | $ 44,893 | $ 230 | $ 493,023 |

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**NOTE 7 ALLOWANCE FOR LOAN LOSSES:**

The following table details activity in the allowance for loan losses by portfolio segment for the period ended September 30, 2014. 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 September 30, 2014**

| (Dollars are in thousands) | Beginning Balance | Charge Offs | Recoveries | Advances | Provisions | Ending Balance |
|---|---|---|---|---|---|---|
| Real estate secured: | | | | | | |
| Commercial | $ 5,203 | $ (1,582) | $ 215 | $ | $ 39 | $ 3,875 |
| Construction and land development | 1,184 | (104) | 13 | | (814) | 279 |
| Residential 1-4 family | 3,316 | (910) | 115 | | 566 | 3,087 |
| Multifamily | 133 | (41) | | | 67 | 159 |
| Farmland | 1,224 | (784) | 520 | | (20) | 940 |
| Total real estate loans | 11,060 | (3,421) | 863 | | (162) | 8,340 |
| Commercial | 1,147 | (47) | 25 | | (528) | 597 |
| Agriculture | 337 | (5) | | | (196) | 136 |
| Consumer installment loans | 153 | (67) | 26 | | 105 | 217 |
| All other loans | 2 | | | | (1) | 1 |
| Unallocated | 381 | | | | 782 | 1,163 |
| Total | $ 13,080 | $ (3,540) | $ 914 | $ | $ | $ 10,454 |

| As of September 30, 2014 (Dollars are in thousands) | Allowance for Loan Losses: Individually Evaluated for Impairment | Allowance for Loan Losses: Collectively Evaluated for Impairment | Allowance for Loan Losses: Total | Recorded Investment in Loans: Individually Evaluated for Impairment | Recorded Investment in Loans: Collectively Evaluated for Impairment | Recorded Investment in Loans: Total |
|---|---|---|---|---|---|---|
| Real estate secured: | | | | | | |
| Commercial | $ 991 | $ 2,884 | $ 3,875 | $ 12,208 | $ 101,557 | $ 113,765 |
| Construction and land development | 92 | 187 | 279 | 686 | 14,587 | 15,273 |
| Residential 1-4 family | 565 | 2,522 | 3,087 | 6,552 | 239,913 | 246,465 |
| Multifamily | 32 | 127 | 159 | 704 | 10,980 | 11,684 |
| Farmland | 396 | 544 | 940 | 7,388 | 18,395 | 25,783 |
| Total real estate loans | 2,076 | 6,264 | 8,340 | 27,538 | 385,432 | 412,970 |
| Commercial | 15 | 582 | 597 | 690 | 20,208 | 20,898 |
| Agriculture | 33 | 103 | 136 | 94 | 3,314 | 3,408 |
| Consumer installment loans | | 217 | 217 | 17 | 26,541 | 26,558 |
| All other loans | | 1 | 1 | | 108 | 108 |
| Unallocated | | 1,163 | 1,163 | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Total | $ 2,124 | $ 8,330 | $ 10,454 | $ 28,339 | $ 435,603 | $ 463,942 |

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The following table details activity in the allowance for loan losses by portfolio segment for the period ended December 31, 2013. 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, 2013**

| (Dollars are in thousands) | Beginning Balance | Charge Offs | Recoveries | Advances | Provisions | Ending Balance |
|---|---|---|---|---|---|---|
| Real estate secured: | | | | | | |
| Commercial | $ 6,720 | $ (2,811) | $ 439 | $ | $ 855 | $ 5,203 |
| Construction and land development | 2,166 | (312) | 452 | | (1,122) | 1,184 |
| Residential 1-4 family | 3,050 | (1,143) | 576 | | 833 | 3,316 |
| Multifamily | 552 | | | | (419) | 133 |
| Farmland | 1,074 | (749) | 68 | | 831 | 1,224 |
| Total real estate loans | 13,562 | (5,015) | 1,535 | | 978 | 11,060 |
| Commercial | 1,772 | (513) | 50 | | (162) | 1,147 |
| Agriculture | 533 | (363) | 51 | | 116 | 337 |
| Consumer installment loans | 388 | (153) | 128 | | (210) | 153 |
| All other loans | 4 | | | | (2) | 2 |
| Unallocated | 551 | | | | (170) | 381 |
| Total | $ 16,810 | $ (6,044) | $ 1,764 | $ | $ 550 | $ 13,080 |

| As of December 31, 2013 | Allowance for Loan Losses | | | Recorded Investment in Loans | | |
|---|---|---|---|---|---|---|
| (Dollars are in thousands) | Individually Evaluated for Impairment | Collectively Evaluated for Impairment | Total | Individually Evaluated for Impairment | Collectively Evaluated for Impairment | Total |
| Real estate secured: | | | | | | |
| Commercial | $ 1,942 | $ 3,261 | $ 5,203 | $ 21,899 | $ 104,275 | $ 126,174 |
| Construction and land development | 138 | 1,046 | 1,184 | 890 | 21,531 | 22,421 |
| Residential 1-4 family | 1,180 | 2,136 | 3,316 | 8,015 | 241,172 | 249,187 |
| Multifamily | 39 | 94 | 133 | 594 | 10,888 | 11,482 |
| Farmland | 653 | 571 | 1,224 | 8,642 | 20,250 | 28,892 |
| Total real estate loans | 3,952 | 7,108 | 11,060 | 40,040 | 398,116 | 438,156 |
| Commercial | 208 | 939 | 1,147 | 987 | 23,968 | 24,955 |
| Agriculture | 43 | 294 | 337 | 115 | 3,603 | 3,718 |
| Consumer installment loans | 3 | 150 | 153 | 34 | 26,021 | 26,055 |
| All other loans | | 2 | 2 | | 139 | 139 |
| Unallocated | | 381 | 381 | | | |
| Total | $ 4,206 | $ 8,874 | $ 13,080 | $ 41,176 | $ 451,847 | $ 493,023 |

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.

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**NOTE 8 TROUBLED DEBT RESTRUCTURINGS:**

At September 30, 2014 there were $9.4 million in loans that are classified as troubled debt restructurings compared to $12.3 million at December 31, 2013. The following table presents information related to loans modified as troubled debt restructurings during the nine and three months ended September 30, 2014 and 2013.

| | For the nine months ended September 30, 2014 | | | For the nine months ended September 30, 2013 | | |
|---|---|---|---|---|---|---|
| **Troubled Debt Restructurings (Dollars are in thousands)** | **# of Loans** | **Pre-Mod. Recorded Investment** | **Post-Mod. Recorded Investment** | **# of Loans** | **Pre-Mod. Recorded Investment** | **Post-Mod. Recorded Investment** |
| Real estate secured: | | | | | | |
| Commercial | | $ | $ | 2 | $ 424 | $ 422 |
| Construction and land Development | | | | | | |
| Residential 1-4 family | 2 | 596 | 596 | | | |
| Multifamily | | | | | | |
| Farmland | | | | | | |
| Total real estate loans | 2 | 596 | 596 | 2 | 424 | 422 |
| Commercial | | | | 1 | 51 | 32 |
| Agriculture | | | | | | |
| Consumer installment loans | | | | 1 | 14 | 14 |
| All other loans | | | | | | |
| Total | 2 | $ 596 | $ 596 | 4 | $ 489 | $ 468 |

| | For the three months ended September 30, 2014 | | | For the three months ended September 30, 2013 | | |
|---|---|---|---|---|---|---|
| **Troubled Debt Restructurings (Dollars are in thousands)** | **# of Loans** | **Pre-Mod. Recorded Investment** | **Post-Mod. Recorded Investment** | **# of Loans** | **Pre-Mod. Recorded Investment** | **Post-Mod. Recorded Investment** |
| Real estate secured: | | | | | | |
| Commercial | | $ | $ | 1 | $ 136 | $ 135 |
| Construction and land Development | | | | | | |
| Residential 1-4 family | 2 | 596 | 596 | | | |
| Multifamily | | | | | | |
| Farmland | | | | | | |
| Total real estate loans | 2 | 596 | 596 | 1 | 136 | 135 |
| Commercial | | | | | | |
| Agriculture | | | | | | |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Consumer installment loans | | | | | | | | | | |
| All other loans | | | | | | | | | | |
| Total | 2 | $ | 596 | $ | 596 | 1 | $ | 136 | $ | 135 |

During the nine months ended September 30, 2014, the Company modified 2 loans that were considered to be troubled debt restructurings. On the 2 loans we modified the terms and lowered the interest rate. During the nine months ended September 30, 2013, the Company modified 4 loans that were considered to be troubled debt restructurings. We modified the terms for 1 loan, lowered the interest rate on 1 loan, and on 2 loans we modified the terms and lowered the interest rate.

There were no loans modified as troubled debt restructurings that defaulted during the nine or three months ended September 30, 2014 and 2013, 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.

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.

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**NOTE 9 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 reflect 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 are determined by the Treasury method. For the three and nine months ended September 30, 2014 and 2013, potential common shares of 2,630,086 and 2,698,828, respectively, were anti-dilutive and were not included in the calculation. Basic and diluted net income per common share calculations follows:

| **(Amounts in Thousands, Except Share and Per Share Data)** | **For the three months ended September 30,** | | **For the nine months ended September 30,** | |
|---|---|---|---|---|
| | **2014** | **2013** | **2014** | **2013** |
| Net income | $ 393 | $ 447 | $ 164 | $ 1,539 |
| Weighted average shares outstanding | 21,872,293 | 21,871,170 | 21,872,293 | 21,870,240 |
| Dilutive shares for stock options and warrants | | | | |
| Weighted average dilutive shares outstanding | 21,872,293 | 21,871,170 | 21,872,293 | 21,870,240 |
| Basic income per share | $ 0.02 | $ 0.02 | $ 0.01 | $ 0.07 |
| Diluted income per share | $ 0.02 | $ 0.02 | $ 0.01 | $ 0.07 |

**NOTE 10 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 September 30, 2014 of 2.00%.

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 September 30, 2014 of 2.83%.

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. In July 2010 the Company and the Bank entered into the Written Agreement discussed in Note 3.

The Written Agreement prohibits the payment of interest on the trust preferred securities without prior regulatory approval. As a result, dividends on trust preferred securities issued by the Company have been deferred until such restriction is removed. This deferral is for a period of 60 months, and could potentially continue until the 1st quarter of 2015. Although the Company has sufficient funds on hand at present to pay the deferred interest and avoid default, a decision of the regulatory authorities to permit payment is required and cannot be assured at this time. During the fourth quarter of 2014 the Company will request regulatory approval to pay the deferred interest before it becomes past due. Failure to obtain this approval will cause a default in the trust preferred securities by the Company. Dividends in arrears on the trust preferred securities were $2.3 million and $2.0 million as of September 30, 2014 and December 31, 2013, respectively and are included in accrued interest payable on the balance sheets.

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**NOTE 11 FAIR VALUES:**

The financial reporting standard, 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 a 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 $97.1 million and $79.1 million at September 30, 2014 and December 31, 2013, 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. Real estate serves as collateral on a substantial majority of the Company s 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 whether or not the fair value of the collateral is further impaired below the appraised value and there is no observable market price, or whether or not an appraised value does not include estimated costs of disposition. The Company records impaired loans as nonrecurring Level 3 assets. The aggregate carrying amounts of impaired loans carried at fair value were $26.2 million and $37.0 million at September 30, 2014 and December 31, 2013, 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 if 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 $13.5 million and $15.9 million at September 30, 2014 and December 31, 2013, respectively.

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Assets and liabilities measured at fair value are as follows as of September 30, 2014 (for purpose of this table the impaired loans are shown net of the related allowance):

| (Dollars are in thousands) | Quoted market price in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
|---|---|---|---|
| (On a recurring basis) | | | |
| Available-for-sale investments | | | |
| U.S. Government Agencies | $ | $ 40,645 | $ |
| Taxable municipals | | 288 | |
| Mortgage backed securities | | 56,130 | |
| (On a non-recurring basis) | | | |
| Other real estate owned | | | 13,541 |
| Impaired loans: | | | |
| Real estate secured: | | | |
| Commercial | | | 11,217 |
| Construction and land development | | | 594 |
| Residential 1-4 family | | | 5,987 |
| Multifamily | | | 672 |
| Farmland | | | 6,992 |
| Commercial | | | 675 |
| Agriculture | | | 61 |
| Consumer installment loans | | | 17 |
| All other loans | | | |
| Total | $ | $ 97,063 | $ 39,756 |

Assets and liabilities measured at fair value are as follows as of December 31, 2013 (for purpose of this table the impaired loans are shown net of the related allowance):

| (Dollars are in thousands) | Quoted market price in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
|---|---|---|---|
| (On a recurring basis) | | | |

| | | | |
|---|---|---|---|
| Available-for-sale investments | | | |
| U.S. Government Agencies | $ | $ 38,601 | $ |
| Mortgage backed securities | | 40,525 | |
| (On a non-recurring basis) | | | |
| Other real estate owned | | | 15,853 |
| Impaired loans: | | | |
| Real estate secured: | | | |
| Commercial | | | 19,957 |
| Construction and land development | | | 752 |
| Residential 1-4 family | | | 6,835 |
| Multifamily | | | 555 |
| Farmland | | | 7,989 |
| Commercial | | | 779 |
| Agriculture | | | 72 |
| Consumer installment loans | | | 31 |
| All other loans | | | |
| Total | $ | $ 79,126 | $ 52,823 |

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For Level 3 assets measured at fair value on a recurring or non-recurring basis as of September 30, 2014, the significant unobservable inputs used in the fair value measurements were as follows:

For Level 3 assets measured at fair value on a recurring or non-recurring basis as of March 31, 2014, the significant unobservable inputs used in the fair value measurements were as follows:

| (Dollars in thousands) | Fair Value at September 30, 2014 | Valuation Technique | Significant Unobservable Inputs | General Range of Significant Unobservable Input Values |
|---|---|---|---|---|
| Impaired Loans | $ 26,215 | Appraised Value/Discounted Cash Flows/Market Value of Note | Discounts to reflect current market conditions, ultimate collectability, and estimated costs to sell | 0 18% |
| Other Real Estate Owned | $ 13,541 | Appraised Value/Comparable Sales/Other Estimates from Independent Sources | Discounts to reflect current market conditions and estimated costs to sell | 0 18% |

**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 September 30, 2014 and December 31, 2013. 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 September 2014 and December 2013.

| | | | Fair Value Measurements | | |
|---|---|---|---|---|---|
| (Dollars are in thousands) | Carrying Amount | Fair Value | Quoted market price in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| **September 30, 2014** | | | | | |
| Financial Instruments Assets | | | | | |
| Net Loans | $ 453,488 | $ 455,828 | $ | $ 429,613 | $ 26,215 |
| Financial Instruments Liabilities | | | | | |
| Time Deposits | 314,138 | 315,544 | | 315,544 | |
| FHLB Advances | 4,458 | 4,458 | | 4,458 | |
| **December 31, 2013** | | | | | |
| Financial Instruments Assets | | | | | |
| Net Loans | $ 479,943 | $ 482,285 | $ | $ 445,315 | $ 36,970 |
| Financial Instruments Liabilities | | | | | |
| Time Deposits | 346,991 | 348,944 | | 348,944 | |
| FHLB Advances | 5,358 | 5,358 | | 5,358 | |

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## NOTE 12 CAPITAL INJECTIONS AND EXERCISE OF COMMON STOCK WARRANTS:

On September 29, 2014 $500 thousand was injected into the Bank s capital from the Company. On October 9, 2014 $1.25 million was injected into the Bank s capital from the Company. The total $1.75 million in capital injections was to increase the capital position and capital ratios of the Bank.

During the month of October 2014, members of the board of directors and management of the Company exercised 1,006,261 common stock warrants at a price of $1.75 per share. As a result an additional $1.761 million of capital was raised at the Company. These funds helped to offset the $1.75 million of funds used for the capital injections mentioned above. As a result the Company still has adequate liquidity to pay its operating expenses and trust preferred interest payments (upon regulatory approval).

## NOTE 13 SUBSEQUENT EVENTS:

On October 31, 2014 the Bank closed four branch locations. The locations are Bland, Norton, and Jonesville, Virginia and Bluewell, West Virginia. At this time management and the board of directors are still discussing the possible future uses of these locations, which could be for administrative uses and also possible future expansion of NPB Insurance Services, Inc. or the possible sale of these branches. The book value of these four branches as of September 30, 2014 was $3.7 million. Future losses may be incurred as a result of the potential writedown of these locations to fair value if the decision is made to sell the branches.

## NOTE 14 RECENT ACCOUNTING DEVELOPMENTS:

The following is a summary of recent authoritative announcements:

In January 2014, the Financial Accounting Standards Board ( FASB ) amended the Receivables topic of the Accounting Standards Codification ( ASC ). The amendments are intended to resolve diversity in practice with respect to when a creditor should reclassify a collateralized consumer mortgage loan to other real estate owned ( OREO ). In addition, the amendments require a creditor reclassify a collateralized consumer mortgage loan to OREO upon obtaining legal title to the real estate collateral, or the borrower voluntarily conveying all interest in the real estate property to the lender to satisfy the loan through a deed in lieu of foreclosure or similar legal agreement. The amendments will be effective for the Company for annual periods, and interim periods within those annual periods beginning after December 15, 2014, with early implementation of the guidance permitted. In implementing this guidance, assets that are reclassified from real estate to loans are measured at the carrying value of the real estate at the date of adoption. Assets reclassified from loans to real estate are measured at the lower of the net amount of the loan receivable or the fair value of the real estate less costs to sell at the date of adoption. The Company will apply the amendments prospectively. The Company does not expect these amendments to have a material effect on its financial statements.

In May 2014, the FASB issued guidance to change the recognition of revenue from contracts with customers. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The guidance will be effective for the Company for reporting periods beginning after December 15, 2016. The Company will apply the guidance using a modified retrospective approach. The Company does not expect these amendments to have a material effect on its financial statements.

In August 2014, the FASB issued guidance that is intended to define management s responsibility to evaluate whether there is substantial doubt about an organization s ability to continue as a going concern and to provide related footnote disclosures. In connection with preparing financial statements, management will need to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the organization s ability to continue as a going concern within one year after the date that the financial statements are issued. The amendments will be effective for the Company for annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. The Company does not expect these amendments 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.

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**Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations**
**Caution About Forward Looking Statements**

We make forward looking statements in this quarterly 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, business strategy, and financial and other goals. The words believes, expects, may, will, should, projects, contemplates, anticipates, forecasts, intends, or other similar words or terms are intended to forward looking statements.

Certain information contained in this discussion may include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements contain the Company s expectations, plans, future financial performance, and other statements that are not historical facts. These forward-looking statements are generally identified by phrases such as the Company expects, the Company believes or words of similar importance. Such forward-looking statements involve known and unknown risks including, but not limited to, changes in general economic and business conditions, interest rate fluctuations, competition within and from outside the banking industry, new products and services in the banking industry, risk inherent in making loans such as repayment risks and fluctuating collateral values, problems with technology utilized by the Company, changing trends in customer profiles and changes in laws and regulations applicable to the Company. Although the Company believes that its expectations with respect to the forward-looking statements are based upon reasonable assumptions within the bounds of its knowledge of its business and operations, there can be no assurance that actual results, performance or achievements of the Company will not differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements.

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.

**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.

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**Written Agreement Progress Report**

At September 30, 2014, 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 worked with independent consultants 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.

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 revised 2013 Budget was submitted to our regulators in the third quarter of 2013. The 2014 Budget was submitted to our regulators in December 2013. A revised 2014 Budget was provided to our regulators in the third quarter of 2014.

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

A new strategic plan for the years 2014 through 2016 was submitted to our regulators in the fourth quarter of 2013. A newly revised 2014-2016 capital plan has been submitted for regulatory review and revisions are being made to resubmit for approval.

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. Because the trust preferred interest deferral period ends in the first quarter 2015 (see Note 10 to the Consolidated Financial Statements), accrued interest becomes due then. Although the Company has sufficient funds on hand at present to pay the deferred interest and avoid default, a decision of the regulatory authorities to permit payment is required and cannot be assured at this time. In addition, the conversion of the director notes to common stock and the recent stock offering included common stock warrants that may be exercised through December 2017 and potentially provide additional capital if, and when, they are exercised.

On September 29, 2014 $500 thousand of capital was injected into the Bank from the Company. On October 9, 2014 an additional $1.25 million of capital was injected into the Bank from the Company to bring the total capital injected into the Bank during 2014 to $1.75 million. This increased the capital position and capital ratios of the Bank.

During the month of October 2014, members of the board of directors and management of the Company exercised 1,006,261 common stock warrants at a price of $1.75 per share. As a result an additional $1.761 million of capital was raised at the Company. These funds helped to offset the $1.75 million of funds used for the capital injections mentioned above. As a result the Company still has adequate liquidity to pay its operating expenses and trust preferred interest payments (upon regulatory approval). During the fourth quarter of 2014 the Company will request regulatory approval to pay the deferred interest before it becomes past due. Failure to obtain this approval will cause a default in the trust preferred securities by the Company.

A total of 1,357,781 common stock warrants were outstanding as of October 31, 2014 with an exercise price of $1.75. Assuming all of these warrants are exercised before expiration, then an additional $2.4 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 to be within 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 brought 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. On February 28, 2014, Stephen Trescot retired as Executive Vice President and Chief Credit Officer of the Bank. Karen Wimmer was appointed as Executive Vice President and Chief Credit Officer of the Bank effective March 1, 2014. Ms. Wimmer previously served as Senior Vice President and Senior Credit Officer of the Bank since the fourth quarter of 2012 in which she reported directly to Mr. Trescot. Ms. Wimmer has a total of 26 years of banking experience. Mr. Trescot may continue to provide consulting services to the Bank on a contractual basis as deemed necessary.

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.

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 two analysts, of which, one analyst is a CPA. The function reports directly to the Executive Vice President and Chief 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 Chief 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 beginning in 2010 through December 2014. 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. In 2013, we began conducting our own loan portfolio stress test.

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 one workout specialist/Vice President, one collector managing other real estate owned properties, a collections supervisor/Vice President, and two support personnel, exclusive of legal department staff. Substantially all the credits in the Bank which are risk rated Substandard or worse are assigned to this department once all efforts to return

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the credit to a satisfactory rating have been exhausted. This department is organizationally structured to manage workout situations, collections, other real estate owned, nonperforming assets, and relevant watch list credits. Also as a functioning part of this department is the Bank s legal department which is co-managed by the Chief Credit Officer and the Chief Executive Officer depending upon the legal issue being addressed. 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 on all problem credits in excess of $1.0 million. A quarterly management watch list committee has been established to actively manage and monitor these credits. Recently an experienced real estate broker was employed under an independent contract basis to facilitate the Bank s need to substantially reduce its OREO portfolio. The consultant/broker individually reviews each OREO property for possible pricing reductions or potential marketing opportunities to allow for an accelerated sale process.

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, 2012, 2013 and 2014 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 the investment portfolio, which has grown to $97.1 million at September 30, 2014 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. During the fourth quarter of 2014 the Company will request regulatory approval to pay the deferred interest before it becomes past due. Failure to obtain this approval will cause a default in the trust preferred securities by the Company. See Note 10 to the Consolidated Financial Statements for more discussion related to the trust preferred securities.

12. Anti-money laundering and bank secrecy act programs and training have been enhanced.

**Overview**

The Company had net income for the quarter ended September 30, 2014 of $393 thousand as compared to net income of $447 thousand for the quarter ended September 30, 2013. Basic net income per share was $0.02 for the quarter ended September 30, 2014 as compared to basic net income per share of $0.02 for the quarter ended September 30, 2013. The Company had net income for the first nine months ending September 30, 2014 of $164 thousand, or basic net income per share of $0.01, as compared to the nine months ending September 30, 2013 whereby the Company had net income totaling $1.5 million, or $0.07 basic net income per share. The decrease in net income for the quarter ended September 30, 2014 and the first nine months of 2014 is primarily the results of decreased interest income from lower loan volume, lower loan interest yields and an increase in other real estate owned expenses when compared to the quarter ended and nine months ended September 30, 2013.

In the third quarter of 2014, our net interest margin was 3.73%, as compared to 4.01% for the same period in 2013. The decrease in net interest income of $621 thousand during the third quarter of 2014 and $2.0 million for the first nine months ending September 30, 2014 as compared to the same period in 2013 is primarily related to a decreased loan portfolio, continued high level of nonperforming assets, and new loans being booked at lower interest rates. In addition, our cost of funds has decreased; however, this decrease has been at a slower pace than the decrease in interest income.

Total deposits decreased $16.2 million from $619.0 million at December 31, 2013 to $602.8 million at September 30, 2014. We have experienced a $16.7 million, or 6.14%, increase in noninterest bearing core deposits, interest bearing demand deposits and savings deposits; however, this increase is offset by a larger volume of time deposits decreasing by $32.9 million, or 9.47%, from $347.0 million at December 31, 2013 to $314.1 million at September 30, 2014. The continued decrease in time deposits due to the interest rate environment is helping us lower our cost of funds.

Total assets decreased $15.3 million, or 2.23%, to $669.4 million at September 30, 2014 from $684.7 million at December 31, 2013. This decrease was due primarily to the decrease in time deposits as mentioned above and the closure of four branch offices that was publicly announced in the third quarter 2014. We believe total assets will continue to decrease somewhat in the near future from the branch closures and also in time deposits as higher priced time deposits mature in the future at much lower interest rates. We closed four branch locations on October 31, 2014 located in Bland, Norton and Jonesville, Virginia and Bluewell, West Virginia. The customers of these locations continue to receive service at our other nearby branches.

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At September 30, 2014, the Company remains well-capitalized. The Tier 1 leverage ratio was 7.57% at September 30, 2014, compared to 7.40% at December 31, 2013. The Tier 1 risk based ratio was 13.38% at September 30, 2014, compared to 12.53% at December 31, 2013. The Total risked based capital ratio was 15.26% at September 30, 2014, compared to 14.39% at December 31, 2013.

At September 30, 2014, the Bank also remains well capitalized under the regulatory framework for prompt corrective action. The following ratios existed at September 30, 2014 for the Bank: Tier 1 leverage ratio of 7.81%, Tier 1 risk based capital ratio of 13.82%, and Total risk based capital ratio of 15.09%. The ratios were as follows at December 31, 2013: Tier 1 leverage ratio of 7.49%, Tier 1 risk based capital ratio of 12.69%, and Total risk based capital ratio of 13.96%.

Total loans have continued to decrease in 2014 by $29.1 million, or 5.90%, to $463.9 million at September 30, 2014 as compared to $493.0 million at December 31, 2013. This is the result of sustained periods of low loan demand, charge offs of $3.5 million for the first nine months of 2014, aggressive resolution of problem loans through collection efforts and selling nonperforming loans, and tighter underwriting guidelines. We anticipate some further decreases in the loan portfolio in the near future as we continue our efforts to decrease nonperforming loans. We expect to replace some of these nonperforming loans with high quality loans and to maintain good lending relationships. We have hired two seasoned commercial lenders in 2014 to help us manage and maintain existing relationships and to develop new business as well. We believe the focus on developing new and existing lending relationships should continue to slow the pace of the reduction of total loans, subject, of course, to the impact of the underperforming economy and heightened competition in the banking industry.

Although asset quality is improving, the level of nonperforming assets remains higher than we desire as a result of the prolonged deterioration of the residential and commercial real estate markets, as well as the recessionary period. However, we have seen improvements during the third quarter of 2014. The ratio of nonperforming assets to total assets lowered to 5.63% at September 30, 2014 as compared to 6.45% at December 31, 2013. Nonperforming assets, which include nonaccrual loans, other real estate owned and past due loans greater than 90 days still accruing interest, decreased to $37.7 million at September 30, 2014 from $44.2 million at December 31, 2013, a reduction of $6.5 million, or 14.73%. The majority of these assets are loans secured by commercial real estate, residential mortgages, and farmland and other real estate owned properties. We are undertaking extensive and more aggressive efforts to work out these credits and liquidate foreclosed properties which we believe will accelerate a reduction of nonperforming assets. Our goal is to reduce the nonperforming assets being mindful of the impact to earnings and capital; however, we may recognize some losses and reductions in the allowance for loan loss as we expedite the resolution of these problem assets as is reflected in earnings for the quarter and first nine months of 2014. In the first nine months of 2014, net charge offs were $2.6 million as compared to $3.2 million in the same period of 2013. Net charge offs for the first nine months of 2014 were related to real estate residential, construction, commercial and farmland loans with collateral values that are dependent upon current market and economic conditions when these are ascertainable and the sale of nonperforming loans sometimes at a steeper discount than normal, with the loss charged off. Delinquencies also showed improvement in the third quarter of 2014 as total past dues decreased to $19.3 million at September 30, 2014 from $30.7 million at December 31, 2013, an improvement of $11.4 million, or 37.27% decrease.

In the second quarter of 2014, two nonperforming loans totaling $3.2 million were sold to further reduce the high level of nonaccrual loans. A charge off of $474 thousand was realized which was fully absorbed by unallocated portion of the allowance for loan losses with no additional provisions needed. We will continue to evaluate certain loans to determine if additional loans may be sold at minimal impact to earnings and to capital levels in the near future as we aggressively work to reduce the level of nonperforming loans.

We have continued our progress in identifying the risks in our loan portfolio and strengthening asset quality. In addition, we have continued to improve our lending policies and train our lending staff on these policies and procedures. Each of these steps is critical to minimize future losses and to strengthen asset quality of the Bank. Our allowance for loan loss at September 30, 2014 is $10.5 million, or 2.25% of total loans as compared to $13.1 million, or 2.65% of total loans at December 31, 2013. No provision for loan losses was recorded during the first nine months of 2014 as compared to $550 thousand in the same period for 2013. The allowance for loan losses is being maintained at a level that management deems appropriate to absorb any potential future losses and known impairments within the loan portfolio whether or not the losses are actually ever realized. We continue to modify the allowance for loan loss model to best reflect the risks in the portfolio and the improvements made in our internal policies and procedures; however, future provisions may be deemed necessary. Impaired loans decreased $12.9 million, or 31.18%, to $28.3 million with an estimated allowance of $2.1 million for potential losses at September 30, 2014 as compared to $41.2 million in impaired loans with an estimated allowance of $4.2 million at the end of 2013.

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## Critical Accounting Policies

For discussion of our significant accounting policies see our Annual Report on Form 10-K for the year ended December 31, 2013. 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 below.

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 in the foreseeable future, 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 below.

## Balance Sheet Changes

At September 30, 2014, total assets were $669.4 million, a decrease of $15.3 million, or 2.23%, from December 31, 2013. Total deposits decreased $16.2 million, or 2.61%, for the first nine months of 2014 to $602.8 million from $619.0 million at December 31, 2013. Total loans decreased $29.1 million, or 5.90%, to $471.6 million at September 30, 2014 from $493.0 million at December 31, 2013.

Core deposits increased as noninterest bearing deposits grew 5.86%, or $8.1 million, from $137.7 million at December 31, 2013 to $145.8 million at September 30, 2014. Overall, we continue to maintain core deposits through attractive consumer and commercial deposit products and strong ties with our customer base and communities. We experienced a small increase of $469 thousand in interest bearing demand deposits during the first nine months of 2014. We continue our efforts to increase core deposit levels.

Savings deposits have grown for the first nine months of 2014 by $8.2 million and a decrease in time deposits of $32.9 million occurred during the first nine months of 2014. The decrease in time deposits, our highest cost deposit funding source, is attributed to our plan to decrease higher cost deposits in order to improve earnings and increase capital ratios. This is the result of decreased interest rates offered in this very low interest rate environment.

We may experience an overall decrease in total deposits over the next year as we closed four offices and combined them with nearby offices on October 31, 2014. This decision was made in June 2014 after we conducted an in-depth internal analysis of our branch network based on profitability, market growth potential, and proximity to other offices.

We are working, however, to increase demand and savings deposits in other branches as we further optimize our branch network and develop our customer relationships. We believe there are opportunities for this segment of deposit growth in various markets that we serve. We also expect to continue to lose higher cost deposits in the near future as some longer term time deposits mature in the future and will reprice most likely at much lower interest rates.

Total loans decreased to $463.9 million at September 30, 2014 from $493.0 million at year end 2013 primarily as the result of decreased loan demand, charge offs of $3.5 million for the first nine months of 2014, foreclosures, nonperforming loan sales and tighter underwriting guidelines. We anticipate the loan portfolio to continue to decrease as we workout problem loans. However, we plan to maintain and, if possible, grow the level of the remaining portion of the loan portfolio with our lending staff. We have recently hired two seasoned commercial lenders to help us manage and grow commercial loans. In addition, we have transferred a special assets officer to agricultural lending in 2014 to help us grow this market. We remain committed to serving our customers. Our lending personnel continue to receive training to meet the needs of our customers and to develop new business with qualified borrowers that will ensure a stronger loan portfolio in the future.

Other real estate owned ( OREO ) decreased $2.4 million to $13.5 million at September 30, 2014 from $15.9 million at December 31, 2013. All properties are available for sale by commercial and residential realtors under the direction of our Special Assets division. We want to reduce the level of OREO faster to reduce the level of nonperforming assets at the Bank, but keeping in mind the impact to earnings and capital. During the first nine months of 2014, we retained the services of a real estate broker to assist us in marketing our OREO properties. The properties were systematically reviewed and management was advised on pricing adjustments that could be taken to help make the properties more marketable, which in some cases reduced the price below the fair value of the property (which is based on an appraisal less estimated disposition costs). As a result of this consultation, we wrote down various properties in the third quarter of 2014 by $27 thousand bringing the total amount of writedowns year-to-date September 30, 2014 to $957 thousand as compared to $149 thousand for the same period of 2013. Newly added properties are being reviewed as they are booked into OREO. This is an ongoing process and as they continue to be monitored, additional writedowns are possible. During the first nine months of 2014, we acquired $2.2 million in other real estate owned as a result of settlement of foreclosed loans, which was offset by sales of $3.4 million of our properties with losses totaling $183 thousand. 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. However, as we are taking a more aggressive approach toward liquidating properties to reduce our level of foreclosed properties, we anticipate the levels to decrease. During 2014, we have begun short-term leasing of certain other real estate owned properties which are generating rental income at market rates. We are doing this to make the properties profitable and more marketable for sale.

Total investments continue to grow as a part of funds management. Total investments have grown $18.0 million during the first nine months of 2014 to $97.1 million at September 30, 2014 from $79.1 million at December 31, 2013. Interest bearing deposits with banks decreased $3.8 million in 2014 to $32.1 million from $35.9 million at December 31, 2013. As deemed appropriate, we will continue to invest surplus overnight funds in investment securities to help increase interest income. Consequently, we anticipate the investment portfolio to continue to grow in the fourth quarter of 2014.

**Net Interest Income and Net Interest Margin**

The Company s primary source of income, net interest income decreased $621 thousand, or 9.91%, to $5.6 million for the third quarter of 2014 from $6.3 million for the same period in 2013. For the first nine months of 2014, net interest income has decreased $2.0 million, or 10.28%, from $19.0 million for the nine months ending September 30, 2013 to $17.0 million for the same period of September 30, 2014.

The decrease in net interest income is due primarily to a reduction in loans during the first nine months of 2014, decreased interest income from new and renewed loans recorded at lower interest rates, and the level of nonearning assets, i.e. nonaccrual loans and other real estate owned properties. Loan interest income decreased $948 thousand, or 13.29%, from $7.1 million for the third quarter of 2013 to $6.2 million for the third quarter of 2014. Loan interest income for the first nine months of 2014 has decreased $3.0 million, or 13.53%, from $21.8 million as of September 30, 2013 to $18.8 million as of September 30, 2014. This is as a result of the decrease in loan volume and loans priced at lower interest rates due to market conditions. With new commercial and agricultural lenders added during 2014, we believe new increased volume will help offset the monthly loan paydowns and maturities. Our goal is to maintain current loan levels of the performing loan portfolio for the near future and then grow the portfolio in the longer term.

Nonaccrual loans have decreased to $24.1 million at September 30, 2014 from $28.3 million at December 31, 2013. Although the nonaccrual loans are trending downward, the continued high volume of nonaccrual loans negatively affects interest income as the majority of these loans are nonearning assets. With regard to recognition of interest income on impaired loans, interest income and cash receipts on impaired loans are handled differently depending on whether or not the loan is on nonaccrual status. If the impaired loan is not on nonaccrual status, then the interest income on the loan is computed using the effective interest method. If there is serious doubt about the collectability of an impaired loan, it is the Bank s policy to stop accruing interest on a loan and classify that loan as nonaccrual 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 are reversed against interest income. The interest on these loans is accounted for on the cash basis or cost-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. In addition, funds generated from a shrinking loan portfolio are reinvested at lower interest rates in both overnight deposits for liquidity purposes and in investment securities. If nonaccruing loans increase, it may reduce our net interest margin further.

We continue to manage our yields on assets and our costs of funds to attempt to improve interest income. As mentioned earlier, our loan portfolio has decreased and as a result the interest income generated by these higher earning assets has been redeployed into investment securities, a lower yielding asset. Investment interest income has grown for the third quarter of 2014 to $366 thousand from $220 thousand for the third quarter of 2013. For the first nine months, interest income from investments increased 72.55%, or $444 thousand, from $612 thousand as of September 30, 2013 to $1.1 million as of September 30, 2014. We anticipate investment interest income to continue to increase in the future as the investment portfolio continues to grow. Although this area of interest income increases, it is at a much lower yield that loan interest income and will not offset the lost loan interest income resulting from a shrinking loan portfolio and high levels of nonaccrual loans.

Interest expense decreased $184 thousand, or 15.82%, from $1.2 million for the quarter ending September 30, 2013 to $1.0 million for the same quarter of 2014 as a result of time 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. Interest expense for the first nine months declined $569 thousand, or 15.70%, to $3.1 million as of September 30, 2014 as compared to $3.6 million as of September 30, 2013.

As a result our net interest margin decreased to 3.73% in the third quarter of 2014 as compared to 4.01% for the same period in 2013. Year-to-date September 30, 2014 and 2013, respectively, our net interest margin decreased to 3.74% from 4.03%. We are trying to preserve the net interest margin as much as possible, but we may experience some decrease in the net interest margin as new and renewed loans are sometimes priced at lower market interest rates, the loan portfolio decreases, funds are invested in lower yielding securities, and opportunities to lower our cost of funds diminish as deposits reprice closer to existing interest rates in the future. Management is addressing this potential negative impact to interest income as deemed appropriate.

**Noninterest Income**

In order to offset the trending decrease in net interest income, we have been working to increase noninterest income. For the third quarter of 2014, noninterest income increased to $1.6 million from $1.5 million for the same period in 2013. Year-to-date September 30, 2014, noninterest income has increased to $4.5 million from $4.2 million in 2013. The majority of the increase comes from increased interchange fee income from the increased issuance of debit cards and also from a stricter policy of waiving fees. Additionally, efforts to increase noninterest income in the future is expected to come from the financial services division of the Bank and the Bank s subsidiary, NPB Insurance Services, Inc., a full-service insurance agency, which began operations in the first quarter of 2013, and deals in personal and group life, property and casualty, health, and disability products.

**Noninterest Expense**

Noninterest expense decreased $414 thousand, or 5.69%, to $6.9 million for the third quarter 2014 as compared to $7.3 million for the third quarter of 2013. Noninterest expenses increased $285 thousand, or 1.35%, for the first nine months of 2014 from $21.1 million as of September 30, 2013 to $21.4 million as of September 30, 2014.

The primary contributor to the increase in expenses for the first nine months of 2014 is related to OREO expenses which management is working diligently to reduce. OREO expenses result from market value adjustments or writedowns, losses on the sale of properties, and expenses related to maintaining the properties, i.e. insurance, taxes, utilities, etc. Due to the aggressive stance that management has taken to reduce these nonperforming assets, higher expenses have been incurred. OREO writedowns have increased to $957 thousand for the first nine months of 2014 as compared to $149 thousand for the same period in 2013. Losses on the sales of OREO properties have decreased to $183 thousand in the first nine months of 2014 as compared to losses of $356 thousand on the sale of OREO properties through September 30, 2013. OREO levels have decreased in 2014 to $13.5 million at September 30, 2014 as compared to $15.9 million at December 31, 2013. We anticipate the levels to continue to decrease; however, we cannot guarantee that this will happen as we continue to resolve problem loans that may end up in foreclosed properties in the future.

Although OREO related expenses increased, nearly every other category of noninterest expenses either decreased or remained nearly the same from third quarter period to period. Year-to-date noninterest expenses showed some increase in data processing and telecommunications expenses due to outsourced statement processing and advertising expenses due to loan promotions. Salaries and benefits slightly decreased $133 thousand in the quarter-to-quarter comparison from $3.3 million at September 30, 2013 to $3.2 million for the same period in 2014. For the nine months ending September 30, 2014, salaries and benefits decreased $381 thousand to $9.6 million as compared to $10.0 million for the same period in 2013. Total full time equivalent employees have decreased to 265 at September 30, 2014 from 272 at September 30, 2013, a reduction of 7, or 2.57%.

In order to further reduce noninterest expenses, we closed four offices and combine them with existing nearby locations on October 31, 2014. We estimate this will generate approximately $1.0 million in cost savings annually most likely beginning in 2015. We will continue to evaluate expenses and strive to improve the overall efficiency of the organization.

Our efficiency ratio, which is defined as noninterest expense divided by the sum of net interest income plus noninterest income, was 94.64% for the third quarter of 2014 as compared to 94.14% for the same period in 2013 and 99.28% for the first nine months of 2014 as compared to 91.03% for the same period in 2013. Included in this calculation are the other real estate owned write-downs which significantly and negatively impact the ratio. We continue to seek opportunities to operate more efficiently through the use of technology, improving processes, reducing nonperforming assets and increasing productivity. We anticipate the efficiency ratio to improve in the future.

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**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 $10.5 million at September 30, 2014 as compared to $13.1 million at December 31, 2013. The allowance for loan losses at September 30, 2014 was approximately 2.25% of total loans as compared to 2.65% at December 31, 2013 and 2.84% at September 30, 2013. Net loans charged off for the first nine months of 2014 were $2.6 million, or 0.73% of average loans, and $3.2 million, or 0.82% of average loans, for the first nine months of 2013. No provision for loan losses was made during the first nine months of 2014 as compared with $550 thousand in the first nine months of 2013, of which no provision was made in the third quarter of 2013. No provisions for loan losses have been made now for six consecutive quarters ending the third quarter of 2014.

We have experienced a decrease in loan delinquencies and decrease in nonaccrual loans during the first nine months of 2014. Loans delinquent greater than 90 days still accruing interest and loans in non-accrual status present higher risks of default and loan losses. At September 30, 2014, there were 155 loans in non-accrual status totaling $24.1 million, or 5.20% of total loans. At December 31, 2013, there were 129 loans in non-accrual status totaling $28.3 million, or 5.74% of total loans. The amounts of interest that would have been recognized on these loans were $70 thousand and $182 thousand for the three months ended September 30, 2014 and 2013, respectively. The amounts of interest that would have been recognized on these loans were $343 thousand and $375 thousand for the nine months ended September 30, 2014 and 2013, respectively. There were no loans past due 90 days or greater and still accruing interest at September 30, 2014 compared to 5 loans past due 90 days or greater and still accruing interest totaling $1 thousand at year end 2013. There were $9.4 million in loans classified as troubled debt restructurings as of September 30, 2014 as compared to $12.3 million in loans classified as troubled debt restructurings as of December 31, 2013. Of the loans classified as troubled debt restructurings at September 30, 2014, $4.8 million were in non-accrual status, compared to $6.8 million at December 31, 2013. 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 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 couple of years due to the increase in natural gas supplies from fracking , layoffs and environmental legislation. We do not foresee a major impact upon the Bank unless an additional 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.

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 2013, we engaged a third party loan review firm to conduct semiannual loan reviews and have engaged them to perform this function in 2014 on a semiannual basis. Our most recent loan review was conducted in June 2014. Upon their review, loans risk ratings may change from the rating assigned by the respective lender. We have experienced minimal 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 our consumer loans and consumer real estate loan portfolio, the Company uses 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 and placed in nonaccrual status. If the loan is unsecured, upon being deemed Substandard, the entire loan amount is charged off.

At 90 days past due, or earlier if the customer has filed bankruptcy, for non 1-4 family residential secured loans, 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 upon the loan becoming contractually

120 days past due, the deficiency is charged-off against the allowance for loan loss. In the case of 1-4 family residential or home equity loans, upon the loan becoming 120 days past due, a current value is obtained and after application of an estimated liquidation discount, a comparison is made to the loan balance to calculate any deficiency. Subsequently, any noted deficiency is then charged-off against the allowance for loan loss when the loan becomes contractually 180 days past due. If the customer has filed bankruptcy, then within 60 days of the bankruptcy notice, any calculated deficiency is charged-off against the allowance for loan loss. Collection efforts continue by means of repossessions or foreclosures, and upon bank ownership, liquidation ensues.

All loans classified as 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. Impaired loans decreased to $28.3 million with $8.9 million requiring a valuation allowance of $2.1 million at September 30, 2014 as compared to $41.2 million with $25.2 million requiring a valuation allowance of $4.2 million at December 31, 2013. Of the $28.3 million recorded as impaired loans, $18.6 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.

In the second quarter of 2014, two nonperforming loans totaling $3.2 million were sold to further reduce the high level of nonaccrual loans. A charge off of $474 thousand was realized which was fully absorbed by unallocated portion of the allowance for loan losses with no additional provisions needed. We will continue to evaluate certain loans to determine if additional loans may be sold at minimal impact to earnings and to capital levels in the near future as we aggressively work to reduce the level of nonperforming loans.

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.

**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 $5.2 million existed at September 30, 2014 compared to $5.4 million at December 31, 2013. During the first nine months of 2014 and 2013 no deferred tax asset valuation allowance was recorded. The total valuation allowance was $6.3 million at September 30, 2014. Management reviewed the September 30, 2014 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 no additional deferred tax asset valuation allowance was required. 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 increased investment income, operational efficiencies realized through cost savings initiatives, and the effects of off-setting deferred tax liabilities, it is more likely than not that all the deferred tax assets, net of the $6.3 million allowance, would be realizable. As of September 30, 2014, the Company had $18.1 million of net operating loss carryforwards which will expire in 2031 thru 2034. 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.

The Company s tax filings for years ended 2010 through 2013 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, 2011, and 2012 are currently under examination by the IRS. The results of the examination could impact the amount of our deferred tax asset, but we do not anticipate a material change if any change at all.

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**Capital Resources**

Total capital at the end of the third quarter of 2014 was $40.7 million as compared to $40.0 million at the end of December 31, 2013. The increase was $707 thousand, or 1.77%. The Bank and the Company were both well capitalized as of September 30, 2014, as defined by the regulatory capital guidelines. The Company s capital as a percentage of total assets was 6.07% at September 30, 2014 compared to 5.84% at December 31, 2013. Book value per common share was $1.86 at September 30, 2014 and $1.83 at December 31, 2013.

Total assets decreased during the first nine months of 2014 and we anticipate asset levels to decrease slightly in the future as a result of branch closures and continued reduction of high cost time deposits. Our primary source of capital comes from retained earnings. We developed a new strategic plan in 2013 and capital plan in 2014. 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. Based upon projections, we believe retained earnings will be sufficient to provide for this economic cycle to increase capital levels. As part of our initiative to improve regulatory capital ratios, we are further reducing our nonperforming assets, and focusing on replacing this reduction with high quality loans as possible. 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.

For regulatory purposes, trust preferred securities are permitted to be included in capital ratios. In 2010, we began deferring interest payments on the trust preferred securities and the 20 consecutive quarter deferral period ends on January 7, 2015. We have reserved funds at the holding company to pay the accrual amount. Under the conditions of the formal written agreement, we are prohibited to pay the deferred interest without obtaining regulatory approval to do so. We have been informed by the Federal Reserve that they may not permit the payment at its due date which would result in the Company being in default. Management is working to meet the conditions which management believes would assist in gaining regulatory approval to allow payment to be made. This is a top priority of management and the board of directors. During the fourth quarter of 2014 the Company will request regulatory approval to pay the deferred interest before it becomes past due. There is no assurance such approval will be granted although the Company and Bank s capital positions have been strengthened by the recent injection of additional capital and the Company s asset quality indicators have improved.

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 our liquid assets in the form of cash, due from banks, federal funds sold, and unpledged available-for-sale investments were $130.4 million at September 30, 2014, up from $116.8 million at December 31, 2013. We plan to invest surplus short-term assets in investment securities and maintain liquidity at levels adequate to meet potential liquidity needs during 2014.

At September 30, 2014, all of our investments are classified as available-for-sale, providing an additional source of liquidity in the amount of $78.7 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 $79.1 million at December 31, 2013 to $97.1 million at September 30, 2014. 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. The $822 thousand increase in fair market value resulted in a net unrealized loss of $632 thousand at September 30, 2014 compared to the net unrealized loss at December 31, 2013, which was $1.5 million. This unrealized loss of $632 thousand, could negatively impact earnings if the investment portfolio had to be quickly liquidated.

Our loan to deposit ratio was 76.96% at September 30, 2014 and 79.65% at year-end 2013. We anticipate this ratio to remain at or below 80% 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 September 30, 2014 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.

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At September 30, 2014, we had borrowings from the Federal Home Loan Bank totaling $4.5 million as compared to $5.4 million at December 31, 2013. 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 or quarterly. The decrease of $900 thousand was due to regularly scheduled principal payments. We also used our line of credit with the Federal Home Loan Bank to issue a letter of credit for $3.0 million in 2010 and $7.0 million in 2013 to the Treasury Board of Virginia for collateral on public funds. An additional $97.9 million was available on September 30, 2014 on the $112.4 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, we have $3.1 million in cash as of September 30, 2014. These funds will be used to pay operating expenses, trust preferred interest payments (upon regulatory approval), and provide additional capital injections to the Bank, if needed. As of now, all interest payments to the trust preferred securities are deferred until January 7, 2015 when they become due in full. The current deferred liability totals $2.3 million and the Company has the funds reserved to pay it when due subject to regulatory approval. In the fourth quarter of 2014 the Company intends to request regulatory approval to pay the deferred interest before it becomes overdue. If such approval is obtained the Company expects to be required to pay future interest installments on the trust preferred securities without further deferral.

On September 29, 2014 $500 thousand was injected into the Bank s capital from the Company. On October 9, 2014 $1.25 million was injected into the Bank s capital from the Company. The total $1.75 million in capital injections was to increase the capital position and capital ratios of the Bank.

During the month of October 2014, members of the board of directors and management of the Company exercised 1,006,261 common stock warrants at a price of $1.75 per share. As a result an additional $1.761 million of capital was raised at the Company. These funds helped to offset the $1.75 million of funds used for the capital injections mentioned above. As a result the Company still has adequate liquidity to pay its operating expenses and trust preferred interest payments (upon regulatory approval).

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 through December 2017 at a price of $1.75 per share. During 2013, 6,758 warrants were exercised, and in the month of October 2014 1,006,361 warrants were exercised which reduced the number of warrants outstanding at October 31, 2014 to 1,357,781. When, and if, these warrants are exercised, additional funds may be received by the Company, which provides potentially up to $2.4 million in additional liquidity and capital at the Company level. Additional contingent funding sources will be explored as available.

**Off Balance Sheet Items and Contractual Obligations**

There have been no material changes during the quarter ended September 30, 2014 to the off-balance sheet items and the contractual obligations disclosed in our annual report on Form 10-K for the fiscal year ended December 31, 2013.

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## Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not Applicable.

## Item 4. Controls and Procedures

We have carried out an evaluation, under the supervision and with the participation of our management, including our President and Chief Executive Officer (our CEO ) and our Executive Vice President and Chief Financial Officer (our CFO ), of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act )) as of the end of the period covered by this report. Based upon that evaluation, our CEO and CFO concluded that our disclosure controls and procedures were operating effectively in providing reasonable assurance that (a) the information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms, and (b) such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

### Changes in Internal Control Over Financial Reporting

There were no changes in the Company s internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the quarter ended September 30, 2014 that have materially affected or are reasonably likely to materially affect the Company s internal control over financial reporting.

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## Part II Other Information

### Item 1. Legal Proceedings

There are no pending or threatened legal proceedings to which the Company or any of its subsidiaries is a party or to which the property of the Company or any of its subsidiaries is subject that, in the opinion of management, may materially impact the financial condition of the Company.

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 was held in April 2013. On January 24, 2014 a hearing was held and in March 2014 the Judge ruled in the Bank s favor regarding VFI s claim of unjust enrichment and a hearing was held in April 2014 to enter an order to this effect and release the lis pendens recorded against the property, however, the Judge declined to release the lis pendens pending resolution of the last remaining claim which is constructive trust and our defenses of unclean hands, laches and mootness. A hearing was held in August 2014 on the remaining claim of constructive trust and a trial has been scheduled for January 2015. Two of the three plaintiffs have withdrawn their claim in this matter. Management and Bank s counsel believe VFI s position is not supported by law or the facts presented.

### Item 1A. Risk Factors

Not Applicable.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Not Applicable

### Item 3. Defaults Upon Senior Securities

Not Applicable

### Item 4. Mine Safety Disclosures

Not Applicable

### Item 5. Other Information

Not Applicable

**Item 6. Exhibits**

See Index of Exhibits.

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## SIGNATURES

Pursuant to the requirements 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.**

**(Registrant)**

By: /s/ JONATHAN H. MULLINS
Jonathan H. Mullins

President and Chief Executive Officer

Date: November 14, 2014

By: /s/ C. TODD ASBURY
C. Todd Asbury

Executive Vice President and Chief Financial Officer

Date: November 14, 2014

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Index of Exhibits

| No. | Description |
|---|---|
| 2.1 | Agreement and Plan of Share Exchange dated August 15, 2011 (incorporated by reference to Exhibit 2 to Form 8-K filed December 17, 2011). |
| 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 New Peoples Bankshares, Inc. (incorporated by reference to Exhibit 3.1 to Form 8-K filed on 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). |

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| 31.1 | Certification by Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act. |
| 31.2 | Certification by Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act. |
| 32 | Certification by Chief Executive Officer and Chief Financial Officer, as required by Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101 | The following materials for the Company s 10-Q Report for the quarterly period ended September 30, 2014, formatted in XBRL: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income (Loss), (iii) the Consolidated Statements of Comprehensive Income, (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. |

* Denotes management contract.