Carter Bank & Trust
POST OFFICE BOX 1776
MARTINSVILLE, VIRGINIA 24115-1776

February 2, 2018

Dear Stockholder:

Attached you will find the financial reports for your Bank for the fourth quarter and year ended December 31, 2017. The Statement of Condition and the Statement of Income as of quarter ended and year ended December 31, 2017, as compared to third quarter of 2017, fourth quarter of 2016, and year ended December 31, 2016 are attached. Unfortunately, we continued to experience the negative impact to earnings from many one-time charges and elevated provision expense during the fourth quarter. These items are related to our continued efforts to aggressively address legacy credit issues and other financial matters so that they will not have lingering impacts to our long-term performance. As stated during previous quarters, our goal is to position your Bank for long-term success. We believe the actions we have taken during 2017 have improved the quality of our balance sheet and have repositioned the Bank to return to more normalized earnings in the near term. We feel we are entering 2018 with a lot of momentum and are confident it will be a successful year for Carter Bank & Trust. The body of this letter offers more detailed commentary on the specific areas of financial performance of Carter Bank & Trust during the quarter and year ended December 31, 2017.

Total assets ended the year at $4.1 billion. This is an 8.7% decline from year end 2016. This shrinkage in our asset base was mainly attributable to the decline in Federal Reserve Excess funds as we funded the runoff of high cost time deposits and continued to deleverage our balance sheet. Total loans were at $2.7 billion at year end. This was essentially flat from the total at December 31, 2016. Organic loan growth was offset by the expected reductions in several large legacy credit relationships. This is consistent with our strategy to create more granularity in our loan portfolio. We have had good luck in adding seasoned lenders in key markets throughout our footprint and expect that we will experience some nice traction in these markets that will result in substantive organic loan growth in the near term.

Nonperforming loans decreased $16.7 million to $92.9 million as of December 31, 2017 from $109.6 million at September 30, 2017 and decreased $26.6 million from $119.5 million as of December 31, 2016. The decrease in nonperforming loans is primarily due to charge-offs on legacy nonperforming credits during 2017 as we continued our aggressive steps to work through our problem credits and improve our overall asset quality. OREO increased $12.6 million as of December 31, 2017 as compared to September 30, 2017, primarily due to the transfer of $13.7 million from bank premises and equipment to OREO for the net remaining book value on the branches marketed for sale. The Bank had purchased several branch locations several years ago for expansion. These expansion plans never materialized and we have decided to divest of these properties.

Federal Reserve Bank excess reserves declined $455.2 million from the year ago period. As mentioned previously, this excess cash was deployed into higher yielding and diversified securities and also funded the planned decrease in high cost deposits during the past twelve months.

The securities portfolio increased $67.5 million and is currently 23.0% of total assets at December 31, 2017 as compared to 19.5% of total assets at December 31, 2016. The increase is a direct result of our strategy to better position the balance sheet to optimize earnings and liquidity. We have made significant progress in diversifying the securities portfolio as to bond types, maturities and interest rate structures.

(Over)

Total deposits as of December 31, 2017 were $3.7 billion as compared to $4.1 billion as of December 31, 2016, a decline of $394.2 million, or 9.7%. Time deposits represented the largest segment of decline in deposits with a $328.0 million decline year-over-year. This reduction is strategically aligned with the Bank's plan to improve the net interest margin. Noninterest bearing deposits decreased slightly by $4.7 million to $530.2 million as of December 31, 2017 as compared to $534.9 million as of December 31, 2016. Noninterest bearing deposits comprised 14.4% and 13.2% of total deposits at December 31, 2017 and 2016, respectively.

The allowance for loan losses was 1.32 % of total loans as of December 31, 2017 as compared to 1.26% as of December 31, 2016. The allowance for loan losses was 38.0% of nonperforming loans as of December 31, 2017 as compared to 28.9% of nonperforming loans as of December 31, 2016. In the view of management, the allowance for loan losses is adequate to absorb probable losses inherent in the loan portfolio.

Despite our significant write-downs in our loan portfolio and the net loss for the year, the Bank remains well capitalized. The Bank's Tier 1 Capital ratio increased to 12.93% as of December 31, 2017 as compared to 12.22% as of December 31, 2016. The Bank's leverage ratio was 9.33% at December 31, 2017 as compared to 8.10% in the same period of 2016. The Bank's Total Risk-Based Capital ratio was 14.15% at December 31, 2017 as compared to 13.35% at December 31, 2016.

Net interest income increased $5.4 million to $106.5 million for the year ended December 31, 2017 as compared to 2016. The increase in net interest income is primarily driven by a $9.3 million decrease in interest expense during the twelve-month period of 2017 as compared to the same period of 2016. This is a result of the intentional runoff of higher cost certificates of deposit. The net interest margin, on a fully taxable equivalent basis, increased 36 basis points to 2.67% over the past twelve months due to our deployment of excess cash into higher yielding and diversified investment securities as well as the aforementioned runoff of higher cost deposits. Our goal continues to be to improve our net interest margin in the long-term to be more reflective of our peer banks.

The provision for loan losses totaled $43.2 million for the year ended December 31, 2017, an increase of $25.5 million as compared to 2016. Net charge-offs were $42.4 million in 2017 as compared to $10.2 million in 2016. During 2017, we have dealt with significant impairment in several large commercial real estate loan relationships. This resulted in significant charge-offs as we aggressively worked toward resolution of these legacy credits. It is our belief that we have effectively identified and realized the significant impairment imbedded in our large problem credits and expect charge-offs and provision expense to be more normalized in 2018.

Noninterest income decreased $0.9 million, or 6.8%, to $11.6 million, excluding net securities gains, for the twelve months ending December 31, 2017 as compared to $12.5 million in 2016. The decline in noninterest income is primarily attributable to lower income from other real estate owned due to the disposition of several properties during the period. Debit card income, a key component of the Bank's noninterest income improved to $4.9 million in 2017 as compared to $4.7 million in 2016. Securities gains of $1.2 million were realized during the second half of 2017 to take advantage of market opportunities and reduce the credit risk of the securities portfolio. We feel that as we reposition our products and services to be more competitive and as many of our strategic initiatives begin to get traction, we will be able to improve our noninterest income levels.

Total noninterest expense increased $16.1 million, or 20.6%, for the year-to-date period of 2017 to $94.3 million as compared to million in the same period of 2016. Several factors contributed to this increase including the following one-time charges:

- $5.3 million in write-downs associated with the vacant branches marketed for sale beginning in the fourth quarter.
- $4.3 million in charges associated with the BSA Look Back Plan as mandated by the BSA Consent Order.
- $6.1 million in adjustments associated with tax credits and the new tax law.
- $4.6 million in write-downs on the existing OREO portfolio.

Also impacting earnings were increases in salaries and employee benefits of $5.2 million, an overall increase in professional and legal fees of $5.7 million and an increase of $2.1 million in data processing license fee. These increases were expected and planned as investments were made in the appropriate infrastructure to support the Bank in the future. Offsetting some of these increases were decreases of $6.1 million on losses on sales and write-downs of OREO due to the disposition of several properties during 2016 and a decrease of $1.0 million in FDIC insurance expense attributable to lower FDIC assessment rates and a decrease in the assessment base.

Overall, 2017 can be characterized as a year of clean up. We have taken aggressive steps to deal with legacy credit problems. The approximately $43 million in loan write-downs during 2017 were the single most impactful element that contributed to our net loss for the year. While we are not pleased with the financial results for 2017, we believe we have taken significant steps to position your Bank for long-term success. We have improved our net interest margin by 65 basis points with continued improvement expected as our balance sheet repositioning efforts continue. We have launched a mortgage lending initiative that will open up new opportunities for us to serve our customer base while providing much needed diversification to our revenue stream. In addition, and perhaps most critical, we are well along on the implementation of the upgrade in our entire technology infrastructure. This new infrastructure will enable us to better serve our customers and greatly enhance our ability to operate efficiently and more effectively meet the regulatory requirements in today's banking environment.

2017 was also a year of transition for Carter Bank & Trust. We were saddened by the untimely passing of our founder Worth Harris Carter, Jr. Mr. Carter is sorely missed by all that knew and cared for him. However, his impact and influence will endure for many years to come as we build on the foundation he created. We have an excellent assembly of committed bankers at Carter Bank & Trust. We believe the initiatives we have begun, the investments we have made, and the steps we have taken will all result in long-term success for your company.

Thank you for your investment in and patronage of Carter Bank & Trust and thank you for your commitment to our future.

Litz H. Van Dyke
Chief Executive Officer

Phyllis Q. Karavatakis
President