CapStone Bank

April 17, 2012

Dear Shareholder:

We are pleased to report CapStone Bank's financial results for the quarter ended March 31, 2012. The first quarter ended with $226 million in total assets compared to $204 million on March 31, 2011, an increase of $22 million or 11%. Total loans for the same period were $155 million compared to $133 million for the same period in 2011, an increase of $22 million or 16%. For the same comparative period, total deposits increased from $137 million to $161 million or 17%. We are especially pleased that non-interest bearing deposits increased by $9 million or 59% during the same period. It is gratifying to report double digit growth in all of these categories during a period when many community banks in North Carolina experienced shrinking balance sheets.

Net income for the period ended March 31, 2012 was $368,750 compared to $428,105 for the same period in 2011, a decrease of $59,355 or 14%. However, pre-tax, pre-provision income for the same comparative period increased from $806,105 to $1,024,750, an increase of $218,645 or 27%. The primary reason for the decline in net income was the increase in the loan loss provision, which was $347,000 higher in the first quarter of 2012 than in the first quarter of 2011. Noninterest income for the first quarter of 2012 increased by $134,340 or 221%, primarily as the result of security sales. Return on average assets was 0.67% for the quarter ended March 31, 2012 versus 0.87% in 2011, while return on average equity was 5.20% compared to 6.48% at the same time last year.

During the first quarter of 2012, nonaccrual loans and other real estate owned increased to 3.50% of total assets from 2.65% at year end 2011. As a result, we added $495,000 to loan loss reserves during the first quarter of 2012 which brought our allowance for loan losses to $4.2 million or 2.71% of loans at March 31, 2012. Even though we are disappointed with the increase in our problem assets, we believe they are at a manageable level.

Overall, we are pleased with our results for the first quarter of 2012. The growth of our balance sheet year over year was very positive, especially in light of the sluggish economic conditions of the past year. The growth in core earnings is encouraging and we are optimistic about the outlook for CapStone Bank for the remainder of 2012.

We look forward to sharing more information with you at our Annual Meeting of Shareholders which will be held at 10:30 a.m. on May 16, 2012 at North Ridge Country Club in Raleigh, NC. Whether or not you plan to attend, I encourage you to return your proxy to ensure that your shares are represented at the meeting.

Sincerely,

Michael S. Patterson
Chairman, President and CEO

CAPSTONE BANK

Balance Sheet

(Unaudited)

	March 2012	March 2011	$ Change	% Change
Assets				
Cash and due from banks	$ 5,163,926	$ 3,399,758	$ 1,764,168	51.9%
Fed funds sold & repos	102,170	8,187,452	(8,085,282)	-98.8%
Interest bearing deposits with banks	17,308,219	24,676,216	(7,367,997)	-29.9%
Investment Securities - Taxable	32,137,514	19,730,368	12,407,146	62.9%
Investment Securities - Tax-exempt	13,632,897	9,826,925	3,805,972	38.7%
Loans, net of unearned income	155,028,976	133,200,899	21,828,077	16.4%
Less: Allowance for loan losses	(4,207,114)	(3,159,764)	(1,047,350)	33.1%
Premises and equipment, net	177,194	259,428	(82,233)	-31.7%
Accrued interest receivable	718,242	680,593	37,649	5.5%
Other assets	5,751,749	6,758,376	(1,006,628)	-14.9%
Total Assets	**$ 225,813,774**	**$ 203,560,252**	**$ 22,253,522**	**10.9%**
Liabilities				
Non-Interest Bearing Deposits	$ 23,169,957	$ 14,610,709	$ 8,559,248	58.6%
Interest bearing demand deposits	26,113,460	24,820,735	1,292,725	5.2%
Savings and Money Market Deposits	57,797,523	38,454,282	19,343,240	50.3%
Time Deposits - Retail	23,399,924	29,275,519	(5,875,595)	-20.1%
Time Deposits - Wholesale	30,197,637	29,714,154	483,484	1.6%
Total Deposits	160,678,501	136,875,399	23,803,102	17.4%
Accrued expenses and other liabilities	1,555,475	1,112,974	442,501	39.8%
FHLB Advances	32,750,000	35,000,000	(2,250,000)	-6.4%
Other Borrowings	2,544,388	3,634,534	(1,090,146)	-30.0%
Total Liabilities	**197,528,364**	**176,622,906**	**20,905,457**	**11.8%**
Equity				
Common stock	12,974,365	10,812,000	2,162,365	20.0%
Capital surplus	11,631,823	13,717,099	(2,085,276)	-15.2%
Retained earnings	2,210,358	1,534,382	675,975	44.1%
Accumulated other comprehensive income (loss)	1,100,115	445,760	654,355	146.8%
Net Income	368,750	428,105	(59,355)	-13.9%
Total Equity	**28,285,410**	**26,937,346**	**1,348,065**	**5.0%**
Total Liabilities & Equity	**$ 225,813,774**	**$ 203,560,252**	**$ 22,253,522**	**10.9%**

CapStone Bank

Income Statement

(Unaudited)

	Year to Date March 2012	Year to Date March 2011	$ Change	% Change
Interest Income				
Interest on Loans	$ 1,868,317	$ 1,929,897	$ (61,580)	-3.2%
Fees on Loans	70,156	55,807	14,349	25.7%
Interest on federal funds sold	766	1,297	(530)	-40.9%
Interest on deposits with banks	86,802	114,346	(27,544)	-24.1%
Investment Securities - Taxable	255,094	206,058	49,036	23.8%
Investment Securities - Tax-exempt	121,814	84,089	37,725	44.9%
Total Interest Income	2,402,950	2,391,494	11,455	0.5%
Interest Expense				
Interest bearing demand deposits	26,739	33,668	(6,929)	-20.6%
Savings and Money Market Deposits	79,535	73,641	5,894	8.0%
Time Deposits - Retail	67,027	108,898	(41,871)	-38.4%
Time Deposits - Wholesale	52,194	58,359	(6,165)	-10.6%
Total Interest Expense on Deposits	225,495	274,566	(49,071)	-17.9%
FHLB Advances	132,606	150,135	(17,529)	-11.7%
Interest on other borrowings	1,443	1,030	412	40.0%
Total Interest Expense	359,543	425,731	(66,188)	-15.5%
Net Interest Income	**2,043,406**	**1,965,763**	**77,643**	**3.9%**
Provision for loan losses	495,000	148,000	347,000	234.5%
Net In. Inc. After Prov. for Loan Losses	**1,548,406**	**1,817,763**	**(269,357)**	**-14.8%**
Non Interest Income				
Service charges and fees	27,513	17,813	9,700	54.5%
Securities gains (losses), net	131,792	2,603	129,188	4963.0%
Mortgage loan and related fees	11,219	4,842	6,376	131.7%
Other noninterest income	24,723	35,648	(10,925)	-30.6%
Total Non Interest Income	195,246	60,906	134,340	220.6%
Non Interest Expense				
Salaries and employee benefits	743,598	778,596	(34,998)	-4.5%
Occupancy	83,446	102,851	(19,405)	-18.9%
Other noninterest expense	386,858	339,117	47,741	14.1%
Total Non Interest Expense	1,213,902	1,220,564	(6,662)	-0.5%
Income Before Taxes	**529,750**	**658,105**	**(128,355)**	**-19.5%**
Income taxes	161,000	230,000	(69,000)	-30.0%
Net Income	**$ 368,750**	**$ 428,105**	**$ (59,355)**	**-13.9%**