

March 5, 2010

Dear Stockholders,

Carolina Financial Corporation is pleased to report earnings of \$7.2 million for fiscal 2009, as compared to \$5.6 million for fiscal 2008, or \$3.72 per common share diluted compared to \$2.83 per common share diluted, respectively.

Total assets at December 31, 2009 were stable at \$1.1 billion when compared to December 31, 2008. Loans receivable, net decreased 11.1% to \$690.2 million at December 31, 2009 from \$776.6 million at December 31, 2008. Total deposits increased to \$761.1 million as of December 31, 2009 from \$717.4 million at December 31, 2008, an increase of 6.1%. Stockholders' equity increased \$9.5 million, primarily due to net income of \$7.2 million and an increase in the market value of securities net of tax of \$2.0 million.

Net interest income for fiscal 2009 increased 6.4% to \$31.7 million, compared to \$29.8 million for fiscal 2008. Provision for loan losses of \$10.5 million in 2009 compared to \$6.4 million in 2008, increased as a result of an increase in non-performing assets. In addition, the company expensed \$5.2 million in 2009 related to other real estate and mortgage loan repurchase losses related to mortgage operations as compared to \$290,000 in 2008. Return on average assets during 2009 was 0.65% while return on average equity was 14.06%.

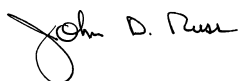
As anticipated, levels of non-performing assets and credit losses increased further during the year as a result of the distressed residential real estate markets and economic recession. Non-performing assets at December 31, 2009 increased to \$35.7 million compared to \$21.0 million at December 31, 2008. While it is difficult to know the full extent of the economic downturn and the resulting impact on Carolina Financial Corporation's credit quality, we expect further increases in non-performing assets, corresponding provisions and expenses and net charge-offs in 2010.

Our wholesale mortgage operations experienced strong activity during 2009, making a significant contribution to our year-end earnings. An increase in refinance activity due to lower interest rates coupled with expanding our own sales efforts in new markets has provided positive results.

We were faced with numerous challenges in 2009 including an increase in non-performing loans, higher loan loss provisions and a greater level of charge-offs as well as an FDIC special deposit insurance assessment. Additionally, total FDIC insurance including the special assessment was \$2.2 million in 2009 compared to \$617,000 in 2008, an increase of \$1.6 million. Nevertheless, credit quality issues remain a major concern and will remain so until the economy meaningfully improves, housing values begin to stabilize and the unemployment situation recovers.

We are glad to have your support as a significant part of our success, sharing our belief that a service-oriented banking institution can successfully compete against larger banking organizations. On behalf of our entire staff and Board of Directors, we thank you for your business, support and trust over the years. I hope to see you at our Annual Meeting of Shareholders in Charleston on April 28, 2010.

Sincerely,



John D. Russ
President and Chief Executive Officer

[This Page Intentionally Left Blank]

CAROLINA FINANCIAL CORPORATION
TABLE OF CONTENTS

Letter to Stockholders	1
Summary of Selected Financial Data	4-5
Financial Discussion	6-19
Independent Auditor's Report	20
Consolidated Financial Statements	
Consolidated Statements of Financial Condition	21
Consolidated Statements of Operations	22
Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income (Loss)	23
Consolidated Statements of Cash Flows	24-25
Notes to Consolidated Financial Statements	26-50
Carolina Financial Corporation's Officers and Directors	51
Community FirstBank of Charleston's Officers and Directors	52
Crescent Bank's Officers and Directors	53
Crescent Mortgage Company's Officers and Directors	54
Carolina Service Corporation's Officers and Directors	55
Corporate Information	56

CAROLINA FINANCIAL CORPORATION

SUMMARY OF SELECTED FINANCIAL DATA

Set forth below are selected consolidated financial and other data of the Company at and for the periods indicated. The information below is only a summary and should be read together with the accompanying Financial Discussion, which follows this data, and the consolidated financial statements presented herein.

	For The Years Ended December 31,				
	2009	2008	2007	2006	2005
Operating Data:			(In Thousands)		
Interest income	\$ 56,736	63,049	65,572	56,073	33,107
Interest expense	25,019	33,227	37,285	29,711	15,113
Net interest income	31,717	29,822	28,287	26,362	17,994
Provision for loan losses	10,460	6,361	1,775	2,755	1,315
Net interest income after provision for loan losses	21,257	23,461	26,512	23,607	16,679
Noninterest income	27,938	9,227	8,869	9,063	10,049
Noninterest expense	37,673	23,882	22,301	20,317	17,364
Income before income taxes	11,522	8,806	13,080	12,353	9,364
Income tax expense	4,353	3,256	4,806	4,543	3,378
Net income	\$ 7,169	5,550	8,274	7,810	5,986

	At December 31,				
	2009	2008	2007	2006	2005
Balance Sheet Data:			(In Thousands)		
Total assets	\$ 1,078,757	1,138,994	977,139	804,435	661,449
Interest-bearing cash	17,759	16,285	4,241	8,311	3,715
Securities available for sale	104,401	120,988	157,456	58,091	45,806
Securities held to maturity	125,633	113,689	-	-	-
Federal Home Loan Bank stock	12,456	11,874	10,147	5,689	5,036
Loans held for sale	71,233	28,283	25,030	30,449	54,357
Loans receivable, net	690,163	776,621	738,705	661,465	517,621
Allowance for loan losses	13,032	11,300	10,083	8,406	5,734
Deposits	761,108	717,389	692,100	622,456	479,154
Short-term borrowed funds	43,787	148,090	85,603	15,117	45,363
Long-term debt	203,638	218,465	137,965	110,465	85,465
Stockholders' equity	56,138	46,591	49,535	40,659	31,883

CAROLINA FINANCIAL CORPORATION
SUMMARY OF SELECTED FINANCIAL DATA

	For The Years Ended December 31,				
	2009	2008	2007	2006	2005
	(In Thousands)				
Selected Average Balances:					
Total assets	\$ 1,098,061	1,090,787	864,497	762,158	554,675
Loans receivable, net	737,448	774,183	708,629	608,868	422,194
Deposits	767,814	750,110	665,252	580,472	397,714
Stockholders' equity	50,986	47,552	44,823	35,615	28,098

Performance Ratios:

Return on average equity	14.06%	11.67%	18.46%	21.93%	21.30%
Return on average assets	0.65%	0.51%	0.96%	1.02%	1.08%
Average earning assets to average total assets	94.70%	95.66%	95.22%	94.83%	94.10%
Average loans receivable, net to average deposits	96.05%	103.21%	106.52%	104.89%	106.16%
Average equity to average assets	4.64%	4.36%	5.18%	4.67%	5.07%
Net interest margin	3.05%	2.86%	3.44%	3.65%	3.45%
Net charge-offs to average loans receivable, net	1.18%	0.66%	0.01%	0.01%	0.00%
Non-performing assets to period end loans receivable, net	5.17%	2.71%	2.18%	0.19%	0.15%
Allowance for loan losses as a percentage of gross loans receivable (end of period)	1.85%	1.44%	1.35%	1.25%	1.10%

	At or For The Years Ended December 31,				
	2009	2008	2007	2006	2005
Per Share Data:					
Book value (end of period)	\$ 29.35	24.36	27.55	22.70	18.75
Basic earnings	3.75	2.95	4.61	4.51	3.53
Diluted earnings	3.72	2.83	4.23	4.10	3.19
Average common shares - basic	1,912,449	1,883,101	1,794,659	1,729,964	1,693,736
Average common shares - diluted	1,924,720	1,960,362	1,954,392	1,902,818	1,876,142

CAROLINA FINANCIAL CORPORATION

FINANCIAL DISCUSSION

Financial Discussion

Carolina Financial Corporation is not a publicly traded company subject to reporting and disclosure requirements of the Securities and Exchange Commission ("SEC") as enumerated in Article 9 of Regulation S-X, Guide 3 or any other requirements for SEC registrants. The Company also does not have an actively traded market for its stock. The accompanying Financial Discussion is provided to assist the reader of these consolidated financial statements and is not intended to comply with disclosure requirements of the SEC as enumerated above.

Discussion of Forward-Looking Statements

The accompanying Financial Discussion contains certain "forward-looking statements" concerning risks and uncertainties about the financial condition and future operations of Carolina Financial Corporation (the "Company") and its wholly-owned subsidiary banks, Community FirstBank of Charleston ("Community FirstBank") and Crescent Bank, (together, the "Banks"), and its wholly-owned subsidiary service corporation, Carolina Services Corporation of Charleston ("Carolina Services"). Effective July 27, 2009, Carolina Financial Corporation contributed 100% of its wholly owned mortgage subsidiary Crescent Mortgage Company ("Crescent Mortgage") to Community FirstBank. Crescent Mortgage continues to operate as a wholly owned subsidiary of Community FirstBank. These forward-looking statements, as defined by federal securities laws, relate to, among others, expectations of the business environment in which the Company operates, projections of future performance, including operating efficiencies, perceived opportunities in the market, potential future credit experience, and statements regarding the Company's mission and vision. These forward-looking statements are based upon Management's current expectations, and may, therefore involve risks and uncertainties. Management's ability to predict results or the effect of future plans or strategies is inherently uncertain. The Company's actual results, performance or achievements may differ materially from those suggested, expressed or implied by forward-looking statements due to a wide range of factors, including, but not limited to, the general business environment, general economic conditions nationally and within the State of South Carolina, interest rates, the South Carolina and national real estate markets, the demand for mortgage loans, the credit risk of lending activities, including changes in the levels of and trends of loan delinquencies and charge-offs, results of examinations by our banking regulators, competitive conditions between banks and non-bank financial service providers, regulatory changes, changes in federal and state tax matters and other risks. No assurance can be given that the results of any forward-looking statements will be achieved and actual results could be affected by one or more factors, which could cause them to differ materially. For these statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act or other applicable legal provisions.

Risk Factors

The Company operates in a business environment that has inherent risks. In addition to the risks and uncertainties described below, other risks and uncertainties not currently known to us or that items we currently deem to be immaterial may become material and adversely affect our business, financial condition and results of operations.

Our business has been adversely affected by downturns in the local economies of our market areas and further downturns could significantly adversely impact our business.

Our business is directly affected by market conditions, industry and finance trends, legislative and regulatory changes, and changes in governmental monetary and fiscal policies and inflation, all of which are beyond our control. Currently our markets are experiencing a prolonged recession and continue to reflect weakness in business and economic conditions that may result in (i) a decrease in the demand for loans and other products and services offered by the Company, (ii) a further decrease in the value of loan collateral, or (iii) a further increase in the number of customers and counterparties who become delinquent, file for bankruptcy protection under bankruptcy laws or default on their loans or other obligations. A further increase in the number of delinquencies, bankruptcies or defaults could result in a higher level of nonperforming assets, net charge-offs, and provision for loan losses that could adversely impact our results of operations and financial condition.

Further downturns in the real estate markets in our primary market area could significantly adversely impact our business.

Our business activities and credit exposure are primarily concentrated in Charleston, Dorchester, and Horry counties in South Carolina. The real estate markets have experienced a significant decline in these markets and these real estate markets may experience further declines. As of December 31, 2009, substantially all of the Company's loan portfolio is secured by real estate located in South Carolina. If real estate values continue to decline, the collateral for these loans will provide less security. As a result, the borrower's ability to pay, or the Company's ability to recover on defaulted loans by selling the underlying collateral, would be diminished.

Higher FDIC insurance premiums adversely affect our earnings.

The FDIC insures deposits for the Banks. The FDIC charges the insured financial institution premiums to maintain the Deposit Insurance Fund. Current economic conditions have increased the number and severity of bank failures and there are expectations for further bank failures. The FDIC issued guidelines that increased premiums paid by insured institutions based on certain risk criteria at the covered

CAROLINA FINANCIAL CORPORATION

FINANCIAL DISCUSSION

financial institution. As a result, the Company experienced an increase in FDIC premiums in 2009 over 2008 of approximately \$1.6 million.

Changes in interest rates could impact our financial condition and results of operations.

The Company's earnings are significantly dependent on net interest income. The primary source of income is net interest income, which is the difference between interest earned on interest-bearing assets and interest paid on interest-bearing liabilities. It is expected that we will periodically experience "gaps" in the interest rate sensitivities of our assets and liabilities, meaning that either our interest-bearing liabilities will be more sensitive to changes in market interest rates than our interest-bearing assets, or vice versa. In either event, if market interest rates should move contrary to our position, this "gap" would negatively impact earnings.

Concern of customers over deposit insurance may cause a decrease in deposits at the Company.

With continued concerns about bank failures, customers are concerned about FDIC insurance coverage on their deposits and may withdraw deposits from the Company in an effort to ensure that the amount they have on deposit with the Company are fully insured. Decreases in deposits may adversely affect our funding costs and net income. The FDIC recently increased FDIC insurance limits on both individual and commercial accounts. Should the FDIC not maintain these increased limits, this could further increase customer concerns.

The fiscal and monetary policy of the federal government and its agencies could have a material adverse effect on our earnings.

The Federal Reserve Board regulates the supply of money and credit in the United States. Its policies determine in large part the cost of funds for lending and investing and the return earned on those loans and investments, both of which affect the net interest margin. They also can materially decrease the value of financial instruments that we hold, such as debt securities and mortgage servicing rights. Its policies also can adversely affect borrowers, potentially increasing the risk that they may fail to repay their loans. Changes in Federal Reserve Board policies are beyond our control and difficult to predict; consequently, the impact of these changes on our activities and results of operations is difficult to predict.

Changes in bankruptcy regulations could adversely affect the Company's business.

As one component to stemming potential foreclosures, the current governmental administration is discussing "bankruptcy cram-downs", whereby a judge, under certain guidelines, could unilaterally modify the terms of the contractual debt agreement between the borrower and the lender. If this or similar legislation becomes effective, the impact could significantly adversely impact the Company's business.

If the allowance for loan losses is not sufficient to cover actual loan losses, earnings will decrease.

Every loan made by the Company carries a risk that it will not be repaid in accordance with its terms or that any collateral securing it will not be sufficient to assure payment. This risk is affected by, among other things, cash flows of borrowers, changes in the value of collateral, borrower credit histories, changes in economic and industry conditions and duration of the loan.

Regulatory agencies, as an integral part of their examination process, review our loans and the allowance for loan losses. Although we believe that the allowance for loan losses is adequate to absorb probable losses in our loan portfolio, we cannot predict these losses or whether our allowance will be adequate or that regulators will not require us to increase this allowance. Any of these occurrences could materially and adversely affect our business, financial condition and profitability.

Our funding sources may prove insufficient to replace deposits and support future growth.

We rely on customer deposits, advances from the Federal Home Loan Bank ("FHLB") and Federal Reserve Bank ("FRB"), and other borrowings to fund operations. Although the Company has historically been able to replace maturing deposits and advances, if desired, no assurance can be given that we would be able to replace such funds in the future if the financial condition of the FHLB or programs sponsored by the FRB or other market conditions were to change. In addition, certain borrowing sources are on a secured basis. Due to changes applied by rating agencies on bonds, changes in collateral requirements or deteriorating loan quality, outstanding borrowings could be required to be repaid, incurring prepayment penalties. Our financial flexibility will be severely constrained if we are unable to maintain access to funding at acceptable interest rates. Finally, if we are required to rely more heavily on more expensive funding sources to support future operations, our revenues may not increase proportionally to cover these costs.

In addition, the Company's mortgage company funds mortgage loans held for sale through warehouse lines of credit and purchase and sale agreements. Due to recent economic conditions, sources of warehouse lending have decreased and could affect Crescent Mortgage's ability to fund loans held for sale.

CAROLINA FINANCIAL CORPORATION

FINANCIAL DISCUSSION

We may elect or be compelled to seek additional capital in the future, but that capital may not be available when it is needed.

We are required by federal regulatory authorities to maintain adequate levels of capital to support our operations. Should we elect or be required by regulatory authorities to raise additional capital, we may seek to do so through the issuance of, among other things, our common or preferred stock. Our ability to raise additional capital, if needed, will depend on conditions in the capital markets, economic conditions and a number of other factors, many of which are outside of our control, and our financial performance. Accordingly, there is no assurance that we will have the ability to raise additional capital if needed or on terms acceptable to us. Failure to be able to raise additional capital could result in the Company not meeting our regulatory capital standards.

If our investment in the Federal Home Loan Bank of Atlanta were impaired in the future, our earnings and stockholders' equity would decrease.

We own common stock of the Federal Home Loan Bank of Atlanta. We hold this stock to qualify for membership in the Federal Home Loan Bank System and to be eligible to borrow funds under the Federal Home Loan Bank's advance program. There is no market for our Federal Home Loan Bank of Atlanta common stock. Recent published reports indicate that certain member banks of the Federal Home Loan Bank System may be subject to accounting rules and asset quality risks that could result in materially lower regulatory capital levels. In an extreme situation, it is possible that the capitalization of a Federal Home Loan Bank, including the Federal Home Loan Bank of Atlanta, could be substantially diminished. Consequently, we believe that there is a risk that our investment in Federal Home Loan Bank of Atlanta common stock could be impaired at some time in the future. If this occurs, it would cause our earnings and stockholders' equity to decrease.

If the decline in value of any of our investment securities becomes other-than-temporary, we are required to write down the value of that security through a charge to earnings.

We review our investment securities portfolio at each quarter-end reporting period to determine whether the fair value is below the current carrying value. When the fair value of any of our investment securities has declined below its carrying value, we are required to assess whether the decline is other than temporary. If we conclude that the decline is other-than-temporary, we are required to write down the value of that security through a charge to earnings. Changes in the expected future cash flows of these securities and/or prolonged price declines may result in our concluding in future periods that the impairment of these securities is other-than-temporary, which would require a charge to earnings to write down these securities to fair value.

The Company is subject to extensive governmental regulation, which could have an adverse impact on our operations.

The banking industry is extensively regulated and supervised under both federal and state law. The Company is subject to the regulation and supervision of the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Company, and the South Carolina Board of Financial Institutions. These regulations are intended primarily to protect depositors, the public and the FDIC insurance fund, and not our shareholders. These regulations govern matters ranging from the maintenance of adequate capital to the general business operations and financial condition of the Company. Any changes in any federal and state law, as well as regulations and governmental policies, income tax laws and accounting principles, could affect the Company in substantial and unpredictable ways, including ways that could adversely affect its business, financial condition or results of operations.

The Company is subject to liquidity risk.

The inability of the Company to raise funds through deposits, borrowings, sale of securities or other sources could have a substantial negative impact on the Company's liquidity. Factors that could detrimentally impact the Company's access to liquidity include a decrease in the level of the Company's business activity or adverse regulatory action against the Company. The Company's ability to borrow could be impaired by such factors as a disruption in the financial markets or negative views and expectations of the prospects for the financial services industry. Although the Company's current sources of funds are considered adequate for its current liquidity needs, there can be no assurance in this regard for the future. If additional debt is needed in the future, there can be no assurance that such debt would be available or, if available, would be on favorable terms. The ability of the Company to raise capital or borrow in the debt markets has been negatively affected by recent economic conditions. If additional financing sources are unavailable or not available on reasonable terms, the Company's financial condition, results of operations and future prospects could be adversely affected.

The Company's 2009 earnings have been highly dependent upon the results of the mortgage operations.

There are a number of items that could adversely affect the volumes and margin of the Company's mortgage operations. These include, but are not limited to, the Federal Reserve mortgage-backed securities purchase program, aggressively low rates, the housing market recovery, the status and financial condition of FNMA and FHLMC, proposed changes in the FHA lending requirements, extensive regulatory changes and liquidity. Should these factors significantly impact production of mortgages, it is likely that the Company's earnings would be adversely affected.

CAROLINA FINANCIAL CORPORATION

FINANCIAL DISCUSSION

The Company's mortgage operations are subject to significant repurchase risk.

The Company is exposed to significant repurchase risk on mortgage loan production related to potential reimbursements for loans sold to third parties for borrower fraud, underwriting and documentation issues, early defaults and prepayments of sold loans. If the Company experiences significant losses related to repurchase risk, it is possible that the reserve established for such exposure is not adequate. We believe that the reserve related to repurchase risk is adequate to absorb probable losses, however, we cannot predict these losses or whether our reserve will be adequate. Any of these occurrences could materially and adversely affect our business, financial condition and profitability.

Hurricanes, earthquakes and other natural disasters may adversely affect loan portfolios and operations and increase the cost of doing business.

The Company operates in markets that are susceptible to natural disasters. Large-scale natural disasters may significantly affect loan portfolios by damaging properties pledged as collateral, affecting the economies our borrowers live in, and by impairing the ability of the borrower to repay their loans.

Overview

Carolina Financial Corporation, a bank holding company, is a Delaware corporation that was incorporated in 1996 and began operations in 1997. We operate principally through Community FirstBank of Charleston and Crescent Bank, both South Carolina state-chartered banks. Our assets are approximately \$1.1 billion at December 31, 2009.

Our subsidiaries provide a full range of financial services designed to meet the financial needs of our customers, including:

- Commercial and retail banking
- Mortgage banking
- Cash management, and
- Retail investment services and asset management.

Carolina Financial, through Community FirstBank and Crescent Bank, currently conducts business through 10 bank branches located in the following counties: Charleston (4), Dorchester (2), and Horry (4) in South Carolina. Effective July 27, 2009, Carolina Financial Corporation contributed 100% of its wholly owned mortgage subsidiary Crescent Mortgage Company ("Crescent Mortgage") to Community FirstBank. Crescent Mortgage is located in Dekalb County, Georgia, and originates loans in 40 states.

Comparison of Operating Results for the Years Ended December 31, 2009 and 2008

Net Income. Net income increased \$1.6 million, or 29.2%, to \$7.2 million, or \$3.72 diluted earnings per share, during 2009 compared to \$5.6 million, or \$2.83 diluted earnings per share, during 2008. The net increase in net income primarily resulted from increases in net interest income of \$1.9 million to \$31.7 million during 2009 compared to \$29.8 million during 2008 offset by an increase in provision for loan losses of \$4.1 million to \$10.5 million during 2009 compared to \$6.4 million during 2008. Noninterest income increased by \$18.7 million to \$27.9 million during 2009 compared to \$9.2 million during 2008. There was also an increase in noninterest expense of \$13.8 million to \$37.7 million during 2009 compared to \$23.9 million during 2008. Income tax expense increased \$1.1 million in 2009 over 2008.

Net Interest Income. Net interest income increased \$1.9 million, or 6.3%, to \$31.7 million during 2009 from \$29.8 million during 2008. This increase is primarily the result of an increase in the Company's net interest margin to 3.05% in 2009 from 2.86% in 2008, an improvement of 19 basis points.

The improvement in net interest margin during fiscal 2009 over fiscal 2008 is primarily the result of the mix of interest-bearing liabilities to lower-rate liabilities and the repricing of higher-rate liabilities, net of the reduction in yield earned on interest-earning assets. The rate paid on interest-bearing liabilities in 2009 was 2.51% as compared to 3.36% in 2008, a reduction of 85 basis points. During fiscal 2009, the Company focused on increasing checking and money market deposits and reducing brokered deposits and higher-rate certificates of deposits. The yield earned on interest-earning assets in 2009 was 5.46% as compared to 6.04% in 2008, a reduction of 58 basis points. Fiscal 2008 experienced a falling rate environment as evidenced by the reduction in the prime rate. During fiscal 2008 the prime rate dropped from 7.25% at the beginning of the year to 3.25% by December 31, 2008. During fiscal 2009, the prime rate remained at 3.25% all year. Accordingly, yields earned on interest-bearing assets and rates paid on interest-bearing liabilities that are tied to the prime rate or other variable index, reflected a reduction in the interest rates.

Total interest income decreased \$6.3 million, or 10.0%, to \$56.7 million during 2009 from \$63.0 million during 2008. Average loans receivable, net decreased \$36.7 million, or 4.7%, to \$737.4 million during 2009 from \$774.2 million during 2008. The yield earned on loans receivable, net decreased to 5.60% from 6.21% during 2009 and 2008, respectively. At December 31, 2009 and 2008, approximately 65% and 70%, respectively, of the loan portfolio consisted of adjustable rate loans and 35% and 30%, respectively, are fixed rate loans.

CAROLINA FINANCIAL CORPORATION

FINANCIAL DISCUSSION

Additionally, the Company's net interest income was adversely affected by the Company's nonaccrual loans that increased to \$27.1 million at the end of 2009 from \$13.9 million at the end of 2008. Lost interest, interest not recorded in the accompanying consolidated statements of operations related to loans on nonaccrual, loans charged off during the period, and loans transferred to real estate acquired through foreclosure, totaled approximately \$1.6 million and \$1.2 for fiscal 2009 and 2008, respectively. The average balance of securities available for sale decreased \$88.4 million, or 45.6%, to \$105.3 million during 2009 from \$193.6 million during 2008. The yield earned on securities available for sale decreased to 5.16% from 5.76% during 2009 and 2008, respectively. During 2009 and 2008, the Company transferred approximately \$30.6 million and \$112.3 million, respectively, of securities available for sale to securities held to maturity. The average balance of securities held to maturity increased \$107.8 million, or 449.2%, to \$131.8 million during 2009 from \$24.0 million during 2008. The yield earned on securities held to maturity decreased to 5.57% from 6.31% during 2009 and 2008, respectively.

Total interest expense decreased \$8.2 million, or 24.7%, to \$25.0 million during 2009 from \$33.2 million during 2008. Average interest-bearing liabilities increased \$8.6 million, or 0.9%, to \$996.6 million during 2009 from \$988.1 million during 2008. Average money market balances increased \$22.1 million, or 22.5%, to \$120.6 million during 2009 from \$98.4 million during 2008. In addition, the effective rate paid on money markets during 2009 was 1.55% compared to 1.90% during 2008. Average short-term borrowings balances decreased \$22.2 million, or 29.1%, to \$54.2 million during 2009 from \$76.4 million during 2008. The effective rate paid during 2009 on these borrowings was 2.51% compared to 2.61% during 2008. Average long-term borrowings balances increased \$9.5 million, or 4.6%, to \$215.6 million during 2009 from \$206.2 million during 2008. The effective rate paid during 2009 on these borrowings was 2.73% compared to 3.49% during 2008.

Provision for Loan Losses. The provision for loan losses increased \$4.1 million to \$10.5 million during 2009 compared to \$6.4 million during 2008. The Company had net charge-offs of \$8.7 million or 1.28% of average loans receivable, net during 2009 compared to net charge-offs of \$5.1 million or 0.66% of average loans receivable, net during 2008. The allowance for loan losses was 1.85% of net loans receivable, or \$13.0 million at December 31, 2009, an increase of \$1.7 million from the allowance for loan losses of \$11.3 million or 1.44% of the loans receivable, at December 31, 2008. The 41 basis point increase in the allowance for loan losses as a percentage of loans receivable, net is primarily due to the increase in non-performing assets to loans receivable, net to 5.17% at December 31, 2009 from 2.71% at December 31, 2008. An additional cause of the increase is continued review of the risk factors related to the underlying loan portfolio, including increased delinquencies of construction mortgages, internal loan level risk rating changes, and slowing external economic conditions in the residential real estate market.

Noninterest Income. Total noninterest income increased \$18.7 million, or 202.8%, to \$27.9 million during 2009 from \$9.2 million during 2008. This increase is primarily attributable to an increase in net gain on sale of loans of \$19.4 million, net of a reduction in the gain on derivatives of \$728,000 and an increase in the loss on extinguishment of debt of \$659,000.

Net gain on sale of loans held for sale increased \$19.4 million, or 423.7%, to \$24.0 million during 2009 compared to \$4.6 million during 2008. The increase in net gain on sale of loans held for sale is due to increased volume and margin. Loans held for sale originations increased to \$1.7 billion during 2009 compared to \$712.8 million during 2008. Margin on loan sales, which includes the gain on sale of loans, net fee income and the change in market value of the pipeline, was 129.6 basis points during 2009 compared to 64.1 basis points during 2008.

Net gain on derivatives in 2009 totaled \$411,000 compared to \$1.1 million during 2008. The decrease in the derivative fair values during the year ended December 31, 2009 was due to unfavorable movement in mortgage interest rates at year-end resulting in a decrease in the derivative values.

The Company incurred losses on extinguishment of debt totaling \$711,000 and \$52,000 in 2009 and 2008, respectively on the prepayment of certain debt advances with interest rates higher than market at the time of the prepayment.

Noninterest Expense. Total noninterest expense increased \$13.8 million, or 57.7%, to \$37.7 million during 2009 from \$23.9 million during 2008. This increase is primarily attributable to increases in salaries and employee benefits expense, other real estate expense, mortgage loan repurchase losses, FDIC insurance and other expenses.

Salaries and employee benefits expense increased a net \$5.7 million, or 39.2%, to \$20.2 million during 2009 from \$14.5 million during 2008. The increase in compensation and benefits in 2009 of \$4.8 million over 2008 primarily relates to an increase in the number of employees at the mortgage company and the related incentives earned during 2009.

Other real estate expense increased \$1.8 million during 2009 related to write-downs of other real estate and the additional expenses of managing other real estate.

Mortgage loan repurchase losses increased \$3.1 million during 2009 as the Company provided for exposure on mortgage loan production related to potential reimbursements for loans sold to third parties for borrower fraud, underwriting and documentation issues, early defaults and prepayments of sold loans.

CAROLINA FINANCIAL CORPORATION

FINANCIAL DISCUSSION

FDIC insurance expense increased \$1.6 million, or 256.7%, to \$2.2 million during 2009 from \$617,000 during 2008 primarily due to higher insurance rates and the FDIC special assessment of \$514,000 in the second quarter of 2009.

Other expense increased \$1.2 million, or 27.0%, to \$5.8 million during 2009 from \$4.5 million during 2008 primarily related to the increased loan volumes at the mortgage company. There were no other individually significant changes.

Income Tax Expense. Income tax expense increased \$1.1 million to \$4.4 million during 2009 from \$3.3 million during 2008. The increase was due to an increase in income before income taxes in 2009. The Company's effective tax rate was 37.8% and 37.0% during 2009 and 2008, respectively.

Comparison of Operating Results for the Years Ended December 31, 2008 and 2007

Net Income. Net income decreased \$2.7 million, or 32.9%, to \$5.6 million, or \$2.83 diluted earnings per share, during 2008 compared to \$8.3 million, or \$4.23 diluted earnings per share, during 2007. The net decrease in net income resulted from increases in net interest income of \$1.5 million to \$29.8 million during 2008 compared to \$28.3 million during 2007 offset by an increase in provision for loan losses of \$4.6 million to \$6.4 million during 2008 compared to \$1.8 million during 2007. Noninterest income increased by \$358,000 to \$9.2 million during 2008 compared to \$8.9 million during 2007. There was also an increase in noninterest expense of \$1.6 million to \$23.9 million during 2008 compared to \$22.3 million during 2007. Income tax expense decreased \$1.6 million in 2008 over 2007.

Net Interest Income. Net interest income increased \$1.5 million, or 5.4%, to \$29.8 million during 2008 from \$28.3 million during 2007. This increase is a result of an increase in average interest-earning assets of \$220.3 million, or 26.8%, to \$1.0 billion in 2008 from \$823.2 million in 2007, which was predominately funded by an increase in average interest-bearing liabilities of \$232.6 million, or 30.8%, to \$988.1 million in 2008 from \$755.5 million in 2007. The Company's net interest margin also decreased 16.9% to 2.9% in 2008 from 3.4% in 2007. This decrease was due to the Company's asset sensitive balance sheet. The majority of the Company's loan portfolio consisting of adjustable rate loans that are indexed to the Company's prime rate began to decrease during the second half of 2007 through 2008 and repriced much more quickly and severely than the Company's borrowings. In addition, due to national liquidity issues, deposits were very competitive in local markets and repriced much less than the federal funds rate. From January 1, 2008 to December 31, 2008 the federal funds rate decreased 4.0% while the Company's cost of deposits only decreased 1.3%. Additionally, the Company's net interest margin was adversely affected by the Company's nonperforming assets, consisting of nonaccrual loans and real estate acquired through foreclosure, that were not accruing interest, increasing to \$21.0 million at the end of 2008 from \$16.1 million at the end of 2007. Lost interest, interest not recorded in the accompanying consolidated statements of operations related to loans on nonaccrual, loans charged off during the period, and loans transferred to real estate acquired through foreclosure totaled approximately \$1.2 million and \$240,000 for fiscal 2008 and 2007, respectively.

Total interest income decreased \$2.5 million, or 3.8%, to \$63.0 million during 2008 from \$65.6 million during 2007. This decrease is primarily attributable to the dynamics of average loan and securities balances and the average annual yields earned. Average loans receivable, net increased \$65.6 million, or 9.2%, to \$774.2 million during 2008 from \$708.6 million during 2007. The yield earned on loans receivable, net decreased to 6.2% from 8.3% during 2008 and 2007, respectively. Approximately 70% of the loan portfolio consists of adjustable rate loans and 30% are fixed rate loans. During fiscal 2008 the prime rate dropped from 7.25% at December 31, 2007 to 3.25% at December 31, 2008. Accordingly, loans tied to the prime rate, or other variable index, resulted in a reduction of the interest rates on these adjustable rate loans. The average balance of securities available for sale increased \$121.4 million, or 168.3%, to \$193.6 million during 2008 from \$72.2 million during 2007. The yield earned on securities available for sale increased to 5.8% from 5.3% during 2008 and 2007, respectively. At September 30, 2008, the Company transferred approximately \$112.3 million of securities available for sale to securities held to maturity. The average balance of securities held to maturity was \$24.0 million with a yield of 6.3%.

Total interest expense decreased \$4.1 million, or 10.9%, to \$33.2 million during 2008 from \$37.3 million during 2007. The decrease in interest expense is attributable to the dynamics of the average balances of interest-bearing liabilities and the yield paid on those liabilities. During fiscal 2008 the prime rate dropped from 7.25% at December 31, 2007 to 3.25% at December 31, 2008. Accordingly, deposits and borrowings, either directly or indirectly tied to the prime rate, or other variable index, resulted in a reduction of the interest rates on these deposits and borrowings. Average interest-bearing liabilities increased \$232.6 million, or 30.8%, to \$988.1 million during 2008 from \$755.5 million during 2007. The increase in the average interest-earning assets was funded primarily through certificates of deposit and borrowings from FHLB and FRB. Average certificate of deposit balances increased \$107.6 million, or 22.8%, to \$580.3 million during 2008 from \$472.7 million during 2007. In addition, the effective yield paid during 2008 was 3.8% compared to 5.1% during 2007. Average short-term and long-term borrowings balances increased \$144.2 million, or 104.1%, to \$282.6 million during 2008 from \$138.4 million during 2007. The effective yield paid during 2008 on these borrowings was 3.2% compared to 6.0% during 2007.

Provision for Loan Losses. The provision for loan losses increased \$4.6 million to \$6.4 million during 2008 compared to \$1.8 million during 2007. The Company had net charge-offs of \$5.1 million or 0.66% of average loans receivable, net during 2008 compared to net charge-offs of \$98,000 or 0.01% of average loans receivable, net during 2007. The allowance for loan losses was 1.4% of loans receivable, or \$11.3 million, at December 31, 2008, an increase of \$1.2 million from the allowance for loan losses of \$10.1 million or 1.4% of the loans receivable, at December 31, 2007. The 0.09% increase in the allowance for loan losses as a percentage of loans receivable, net is primarily due to the increase in non-performing assets to loans receivable, net to 2.7% at December 31, 2008 from 2.2% at December 31,

CAROLINA FINANCIAL CORPORATION

FINANCIAL DISCUSSION

2007. An additional cause of the increase is continued review of the risk factors related to the underlying loan portfolio, including increased delinquencies of construction mortgages, internal loan level risk rating changes, and slowing external economic conditions in the residential real estate market.

Noninterest Income. Total noninterest income increased \$358,000, or 4.0%, to \$9.2 million during 2008 from \$8.9 million during 2007. This increase is primarily attributable to an increase in net gain on derivatives of \$1.2 million, an increase in sales of non-depository products of \$810,000 and an increase in deposit service charges of \$374,000, net of a decrease in the net gain on sale of loans held for sale of \$1.9 million in 2008 compared to 2007.

Net gain on sale of loans held for sale decreased \$1.9 million, or 29.2%, to \$4.6 million during 2008 compared to \$6.5 million during 2007. The decrease in net gain on sale of loans held for sale was primarily due to decreased volume as originations of loans held for sale decreased to \$712.8 million during 2008 compared to \$949.1 million during 2007. The Company's margin on loan sales was 64.1 basis points during 2008 compared to 67.3 basis points during 2007.

Deposit service charges increased \$374,000, or 34.8%, to \$1.4 million during 2008 from \$1.1 million during 2007. This increase is primarily attributable to an increase in commercial NSF charges.

During the latter part of 2007, the Company began offering non-depository products through its relationship with Raymond James Financial Services ("Raymond James"), including stocks, bonds, mutual funds, annuities, insurance and retirement products. Revenues from sales of these non-depository products were \$867,000 and \$57,000 in 2008 and 2007, respectively.

During the fourth quarter of 2007 and the first six months of 2008, the Company restructured part of its securities portfolio to add more duration in anticipation of falling interest rates and take advantage of higher yields in various investment grade securities. In 2008, the Banks sold \$65.0 million of securities recognizing a \$952,000 net gain on sale of available for sale securities. In 2007, the Banks sold \$18.8 million of securities recognizing a \$477,000 gain on sale of available for sale securities. The Banks used the proceeds in both years to purchase various mortgage-backed securities.

Net gain on derivatives in 2008 totaled \$1.1 million compared to a \$13,000 loss during 2007. The increase in the derivative fair values during the year ended December 31, 2008 was due to favorable movement in mortgage interest rates resulting in an increase in the derivative values as well as an increase in the volume of interest rate locks.

Noninterest Expense. Total noninterest expense increased \$1.6 million, or 7.1%, to \$23.9 million during 2008 from \$22.3 million during 2007. This increase is attributable to increases in salaries and employee benefits expense, occupancy and equipment expense, FDIC insurance and other expenses.

Salaries and employee benefits expense increased a net \$376,000, or 2.7%, to \$14.5 million during 2008 from \$14.1 million during 2007. During 2008, compensation and benefits increased \$1.6 million, offset by a \$1.1 million reduction of expense related to a change in the Company's short-term disability program. Prior to changing the short-term disability program to a third-party insurance program, the Company self-insured for short-term disability. Upon termination of the plan, the Company reversed an accrual of approximately \$1.1 million into 2008 earnings. The increase in compensation and benefits primarily relates to an increase in commission expense related to the Raymond James relationship of \$379,000, normal annual merit increases and an increase in full-time equivalents at December 31, 2008 to 217 compared to 204 at December 31, 2007.

Occupancy and equipment expense increased \$274,000, or 10.0%, to \$3.0 million during 2008 from \$2.7 million during 2007. The year over year increase is primarily attributable to an \$84,000 increase in ATM expenses for the five ATM machines added during fiscal 2008. In addition, depreciation increased approximately \$96,000 related to additions to property and equipment. Rent expense increased approximately \$60,000 primarily due to acquiring space for the non-depository operations.

FDIC insurance expense increased \$151,000, or 32.4%, to \$617,000 during 2008 from \$466,000 during 2007. The increase is primarily related to an increase in bank deposits. During 2007, the FDIC started charging deposit insurance assessments to all insured institutions in order to increase the reserve ratios of the FDIC Deposit Insurance Fund.

Other expense increased \$734,000, or 17.9%, to \$4.8 million during 2008 from \$4.1 million during 2007. The increase is primarily attributable to an increase in legal and other expenses related to managing nonperforming assets of \$201,000, mortgage-banking expenses related to reimbursements related to early defaults and prepayments of sold loans of \$190,000. There were no other individually significant changes.

Income Tax Expense. Income tax expense decreased \$1.6 million to \$3.3 million during 2008 from \$4.8 million during 2007. The decrease was due to lower income before income taxes in 2008. The Company's effective tax rate was 37.0% and 36.7% during 2008 and 2007, respectively.

CAROLINA FINANCIAL CORPORATION
FINANCIAL DISCUSSION

Analysis of Changes in Net Interest Income

The following table shows changes in interest income and interest expense based upon changes in volume and changes in interest rates during the periods indicated:

	For The Years Ended December 31,							
	2009 vs. 2008				2008 vs. 2007			
	Increase (decrease) due to		Rate/	Net Dollar	Increase (decrease) due to		Rate/	Net Dollar
	Volume	Rate	Volume	Change	Volume	Rate	Volume	Change
	(Dollars In Thousands)							
Loans held for sale	\$ 780	248	138	1,166	(401)	(178)	37	(542)
Loans receivable, net	(2,283)	(4,732)	225	(6,790)	5,459	(14,970)	(1,385)	(10,896)
Interest-bearing cash	16	(388)	(15)	(387)	511	(159)	(259)	93
Securities available for sale	(5,086)	(1,164)	531	(5,719)	6,434	331	558	7,323
Securities held to maturity	6,801	(177)	(797)	5,827	-	-	1,514	1,514
FHLB stock	24	(367)	(22)	(365)	306	(156)	(126)	24
Other investments	(26)	(32)	13	(45)	(2)	(37)	1	(38)
Interest income	<u>226</u>	<u>(6,612)</u>	<u>73</u>	<u>(6,313)</u>	<u>12,307</u>	<u>(15,169)</u>	<u>340</u>	<u>(2,522)</u>
Demand accounts	10	(50)	(3)	(43)	(9)	(117)	4	(122)
Money market accounts	421	(351)	(79)	(9)	(706)	(2,242)	354	(2,594)
Savings accounts	4	(2)	(1)	1	1	(9)	-	(8)
Certificates of deposit	(110)	(6,125)	31	(6,204)	5,512	(6,311)	(1,436)	(2,235)
Short-term borrowed funds	(581)	(79)	23	(637)	3,311	(1,067)	(2,006)	238
Long-term debt	330	(1,479)	(68)	(1,217)	5,500	(2,625)	(2,211)	664
Interest expense	<u>74</u>	<u>(8,086)</u>	<u>(97)</u>	<u>(8,109)</u>	<u>13,609</u>	<u>(12,371)</u>	<u>(5,295)</u>	<u>(4,057)</u>
Net interest income	<u>\$ 152</u>	<u>1,474</u>	<u>170</u>	<u>1,796</u>	<u>(1,302)</u>	<u>(2,798)</u>	<u>5,635</u>	<u>1,535</u>

CAROLINA FINANCIAL CORPORATION
FINANCIAL DISCUSSION

Yields on Average Interest-Earning Assets and Rates on Average Interest-Bearing Liabilities

The following table summarizes the Company's yields on average interest-earning assets and rates on average interest-bearing liabilities during the periods indicated:

	For The Years Ended December 31,					
	2009			2008		
	Average Balance	Interest Paid/ Earned	Average Yield/ Rate	Average Balance	Interest Paid/ Earned	Average Yield/ Rate
	(Dollars In Thousands)					
Interest-earning assets:						
Loans held for sale	\$ 35,761	2,567	7.18%	22,973	1,401	6.10%
Loans receivable, net (1)	737,448	41,325	5.60%	774,183	48,115	6.21%
Interest-bearing cash	17,038	19	0.11%	16,412	407	2.48%
Securities available for sale	105,265	5,427	5.16%	193,616	11,146	5.76%
Securities held to maturity	131,760	7,341	5.57%	23,991	1,514	6.31%
Federal Home Loan Bank stock	12,153	39	0.32%	11,474	403	3.51%
Other investments	465	18	3.87%	802	63	7.86%
Total interest-earning assets	<u>1,039,890</u>	<u>56,736</u>	<u>5.46%</u>	1,043,451	63,049	6.04%
Non-earning assets	<u>58,170</u>			<u>47,336</u>		
Total assets	<u><u>1,098,060</u></u>			<u><u>1,090,787</u></u>		
Interest-bearing liabilities:						
Demand accounts	26,231	123	0.47%	24,726	166	0.67%
Money market accounts	120,573	1,864	1.55%	98,448	1,873	1.90%
Savings accounts	2,643	16	0.61%	2,029	14	0.69%
Certificates of deposit	577,364	15,778	2.73%	580,264	21,983	3.79%
Short-term borrowed funds	54,211	1,361	2.51%	76,455	1,998	2.61%
Long-term debt	215,626	5,877	2.73%	206,170	7,193	3.49%
Total interest-bearing liabilities	<u>996,648</u>	<u>25,019</u>	<u>2.51%</u>	988,092	33,227	3.36%
Noninterest-bearing deposits	41,003			44,643		
Other liabilities	9,422			10,500		
Stockholders' equity	<u>50,987</u>			<u>47,552</u>		
Total liabilities and stockholders' equity	<u><u>\$ 1,098,060</u></u>			<u><u>1,090,787</u></u>		
Net interest spread			<u>2.95%</u>			<u>2.68%</u>
Net interest margin	<u>3.05%</u>			<u>2.86%</u>		
Net interest income		<u><u>31,717</u></u>			<u><u>29,822</u></u>	

(1) Average balances of loans include non-accrual loans.

CAROLINA FINANCIAL CORPORATION

FINANCIAL DISCUSSION

Loans by Type

The following table summarizes loans by type and percent of total at the end of the periods indicated:

	At December 31,			
	2009		2008	
	Amount	% of Total Loans	Amount	% of Total Loans
	(Dollars In Thousands)			
Loans Receivable:				
Residential mortgage	\$ 53,094	7.31%	57,682	6.87%
Commercial mortgage	301,344	41.46%	322,595	38.42%
Construction mortgage	14,639	2.01%	66,279	7.89%
Commercial loans	284,889	39.19%	312,099	37.17%
Consumer loans	72,917	10.03%	80,993	9.65%
Total gross loans receivable	726,883	100.00%	839,648	100.00%
Less:				
Undisbursed loans in process	23,230		51,000	
Allowance for loan losses	13,032		11,300	
Deferred fees, net	458		727	
Loans receivable, net	\$ 690,163		776,621	

Non-Performing and Problem Assets

The following table summarizes non-performing and problem assets at the end of the periods indicated.

	At December 31,	
	2009	2008
	(In Thousands)	
Non-Performing Assets		
Non-accrual loans-renegotiated loans	\$ 3,505	-
Non-accrual loans-other	23,554	13,923
Accruing loans 90 days or more delinquent	771	13
Real estate acquired through foreclosure, net	7,853	7,105
Total Non-Performing Assets	\$ 35,683	21,041
Problem Assets not included in Non-Performing Assets		
Accruing renegotiated loans	\$ 5,269	1,103

Substantially all of the non-accrual loans, accruing loans 90 days or more delinquent and accruing renegotiated loans for fiscal 2009 and 2008 are collateralized by real estate. Management believes based on information known and available currently, the probable losses related to problem assets are adequately reserved in the allowance for loan losses.

Market Risk Management and Interest Rate Risk

The effective management of market risk is essential to achieving the Company's objectives. As a financial institution, the Company's most significant market risk exposure is interest rate risk. The primary objective of managing interest rate risk is to minimize the effect that changes in interest rates have on net income. This is accomplished through active asset and liability management, which requires the strategic pricing of asset and liability accounts and management of appropriate maturity mixes of assets and liabilities. The expected result of these strategies is the development of appropriate maturity and repricing opportunities in those accounts to produce consistent net income during periods of changing interest rates. The Banks' Asset/Liability Management Committees ("ALCO") monitor loan, investment and liability portfolios to ensure comprehensive management of interest rate risk. These portfolios are analyzed for proper fixed-rate and variable-rate mixes under various interest rate scenarios. The asset/liability management process is designed to achieve relatively stable net interest margins and assure liquidity by coordinating the volumes, maturities or repricing opportunities of interest-earning assets, deposits and borrowed funds. It is the responsibility of the ALCO to determine and achieve the most appropriate volume

CAROLINA FINANCIAL CORPORATION

FINANCIAL DISCUSSION

and mix of interest-earning assets and interest-bearing liabilities, as well as ensure an adequate level of liquidity and capital, within the context of corporate performance goals. The ALCO also set policy guidelines and establishes long-term strategies with respect to interest rate risk exposure and liquidity. The ALCO meet regularly to review the Company's interest rate risk and liquidity positions in relation to present and prospective market and business conditions, and adopt funding and balance sheet management strategies that are intended to ensure that the potential impact on earnings and liquidity as a result of fluctuations in interest rates is within acceptable standards.

The Company uses interest rate sensitivity analysis to measure the sensitivity of projected net interest income to changes in interest rates. Management monitors the Company's interest sensitivity by means of a computer model that incorporates current volumes, average rates earned and paid, and scheduled maturities, payments of asset and liability portfolios, together with multiple scenarios of prepayments, repricing opportunities and anticipated volume growth. Interest rate sensitivity analysis shows the effect that the indicated changes in interest rates would have on net interest income as projected for the next twelve months under the current interest rate environment. The resulting change in net interest income reflects the level of sensitivity that net interest income has in relation to changing interest rates.

The following table summarizes the Company's interest rate sensitivity position at the Banks as of December 31, 2009:

Interest Rate Scenario		Percentage Change in Net Interest Income
Change	Prime Rate	
0.00%	3.25%	0.00%
1.00%	4.25%	-1.05%
2.00%	5.25%	-1.73%
3.00%	6.25%	3.25%

The Company also uses derivatives intended to reduce interest rate risk incurred as a result of market movements. These derivatives primarily consist of mortgage loan interest rate lock commitments, forward mortgage loan sales commitments and options to deliver mortgage-backed securities. A derivative is a financial instrument that derives its cash flows, and therefore its value, by reference to an underlying instrument, index or referenced interest rate. The Company uses derivatives primarily to minimize interest rate risk related to its pipeline of loan interest rate lock commitments issued on residential mortgage loans in the process of origination for sale or loans held for sale. Forward mortgage loan sales commitments and options to deliver mortgage-backed securities that generally correspond with the composition of the locked pipeline are used to economically hedge a percentage of the Company's locked pipeline. The Company's Secondary Market Committee has developed a comprehensive hedging policy to monitor the use of derivatives to reduce interest rate risk. The Company's derivative positions are classified as trading assets and liabilities, and as such, the changes in the fair market value of the derivative positions are recognized in the consolidated statement of operations.

The derivative positions of the Company at December 31, 2009 and 2008 are as follows:

	2009		2008	
	Fair Value	Notional Value	Fair Value	Notional Value
	(In Thousands)			
Derivative assets -				
Mortgage loan interest rate lock commitments	\$ 428	46,588	1,999	222,994
Forward mortgage loan sales commitments	1,914	130,000	-	-
	<u>\$ 2,342</u>		<u>1,999</u>	
Derivative liabilities -				
Forward mortgage loan sales commitments	\$ 891	177,282	959	121,000

CAROLINA FINANCIAL CORPORATION

FINANCIAL DISCUSSION

Liquidity and Financial Condition

The Company's assets and liabilities are monitored on a daily basis to ensure funds are available to meet liquidity requirements. The Company also utilizes borrowing facilities in order to maintain adequate liquidity including: the Federal Home Loan Bank of Atlanta ("FHLB") advance window, the Federal Reserve Bank ("FRB"), federal funds purchased, and warehouse lines of credit. Periodically, the Company will use wholesale deposit products, including brokered deposits as well as national certificate of deposit services. Additionally, the Company has certain investment securities classified as available for sale that are carried at market value with changes in market value, net of tax, recorded through stockholders' equity.

Lines of credit with the Federal Home Loan Bank of Atlanta are based upon FHLB-approved percentages of Bank assets, but must be supported by appropriate collateral to be available. The Banks have pledged approximately \$177.8 million of first lien residential mortgage, second lien residential mortgage, residential home equity line of credit, commercial mortgage and multifamily mortgage portfolios under blanket lien agreements as collateral for these advances. In addition, the Company has pledged \$59.8 million of securities for these advances. At December 31, 2009, the Banks had maximum FHLB lines of \$339.1 million based on FHLB limits. At December 31, 2009, the Banks pledged collateral totaling \$237.6 million to support FHLB advances. At December 31, 2009 the Banks had FHLB advances of \$176.5 million outstanding, with excess collateral pledged to the FHLB that would support additional borrowings of approximately \$61.0 million.

Lines of credit with the FRB are based on collateral pledged. The Banks have pledged certain non-mortgage commercial, acquisition and development, and lot loan portfolios under blanket lien agreements as collateral to the FRB for these advances. At December 31, 2009 the Banks had lines available with the FRB for \$71.6 million. At December 31, 2009 the Banks had no FRB advances outstanding, with excess collateral pledged to the FRB that would support additional borrowings of approximately \$71.6 million.

The mortgage loan warehouse line of credit is an extension of credit facility from a correspondent bank to Crescent Mortgage with a \$35.0 million credit limit, of which \$15.9 million is still available. The facility is secured by Crescent Mortgage's residential mortgage loans held for sale and other assets.

During 2008, the Company modified a \$5.0 million unsecured line of credit with a correspondent bank, of which \$3.0 million is outstanding at December 31, 2009, to be extended to March 31, 2020. In connection with this modification, the Company obtained a \$3.0 million subordinated debenture that, as a condition to the line of credit modification, requires the Company to keep at least a \$500,000 principal balance outstanding on the line of credit until the subordinated debenture is paid in full. If the Company does not maintain the \$500,000 balance, there is a \$150,000 prepayment penalty. During 2009, the Company has maintained at least a \$500,000 principal balance outstanding on the line of credit. During 2009, the correspondent bank was put into receivership with the Federal Deposit Insurance Corporation ("FDIC"). As a result, the undrawn \$2 million of availability under this unsecured line of credit has been withdrawn by the FDIC. The line of credit also has debt covenants, the more restrictive of which requires the Company to maintain certain capital ratios and return on asset ratios. As of December 31, 2009, the Company is not in compliance with all of the covenants. While the lender has not called the line of credit, it has the right to do so. Accordingly, the Company has developed alternatives to replace this line of credit, if necessary, by obtaining financing from other sources or by receiving dividends from its subsidiaries in accordance with regulatory requirements to pay off the debt. As a result, management does not believe that default of this covenant will have a material adverse affect on the Company's financial condition or the results of its operations.

Capital Resources

The Company and the Banks are subject to numerous regulatory capital requirements administered by federal banking agencies. If these capital requirements are not met, regulators can initiate certain mandatory – and possibly additional discretionary – actions that, if undertaken, could affect operations. Under capital adequacy guidelines and the regulatory framework for corrective action, the Company and the Banks must meet certain capital guidelines, which involve quantitative measures of the Company's and the Banks' assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's and the Banks' capital amounts and classification are subject to qualitative judgments by the regulators about components, risk weightings and certain other factors.

Quantitative measures set up by regulation to guarantee capital adequacy require the Company and the Banks to sustain minimum amounts and ratios of Tier 1 capital and total risk based capital to risk-weighted assets and Tier 1 capital to total average assets. The Company and the Banks are required to maintain minimum Tier 1 capital and total risk based capital to risk weighted assets, and Tier 1 capital to total average assets of 4%, 8%, and 3%, respectively. To be considered "Well Capitalized", the Company and the Banks must maintain at least Tier 1 capital and total risk based capital to risk weighted assets, and Tier 1 capital to total average assets of 6%, 10%, and 5%, respectively. As of December 31, 2008, the Company and the Banks are considered "Well Capitalized" under regulatory capital adequacy guidelines.

CAROLINA FINANCIAL CORPORATION

FINANCIAL DISCUSSION

The following schedule shows the Company's and the Banks' actual capital amounts and ratios at December 31, 2009 and 2008:

	2009		2008	
	Amount	Ratio	Amount	Ratio
	(Dollars In Thousands)			
Carolina Financial Corporation				
Tier 1 capital (to risk weighted assets)	\$ 78,773	9.2%	71,208	8.4%
Total risk based capital (to risk weighted assets)	101,696	11.9%	94,780	11.2%
Tier 1 capital (to total average assets)	78,773	7.3%	71,208	6.4%
Community FirstBank				
Tier 1 capital (to risk weighted assets)	45,166	10.4%	36,590	8.9%
Total risk based capital (to risk weighted assets)	55,633	12.8%	46,754	11.3%
Tier 1 capital (to total average assets)	45,166	7.7%	36,590	6.6%
Crescent Bank				
Tier 1 capital (to risk weighted assets)	35,404	8.4%	33,806	8.1%
Total risk based capital (to risk weighted assets)	47,849	11.4%	47,027	11.3%
Tier 1 capital (to total average assets)	35,404	7.2%	33,806	6.3%

Recently Adopted Accounting Standards

The following is a summary of recent authoritative pronouncements that could impact the accounting, reporting, and disclosure of financial information by the Company.

In June 2009, the Financial Accounting Standards Board ("FASB") issued guidance that restructured generally accepted accounting principles ("GAAP") and simplified access to all authoritative literature by providing a single source of authoritative nongovernmental GAAP. The guidance is presented in a topically organized structure referred to as the FASB Accounting Standards Codification ("ASC"). The new structure is effective for interim or annual periods ending after September 15, 2009. All existing accounting standards have been superseded and all other accounting literature not included are considered nonauthoritative.

The FASB issued new accounting guidance on accounting for transfer of financial assets in June 2009. The guidance limits the circumstances in which a financial asset should be derecognized when the transferor has not transferred the entire financial asset by taking into consideration the transferor's continuing involvement. The standard requires that a transferor recognize and initially measure at fair value all assets obtained (including a transferor's beneficial interest) and liabilities incurred as a result of a transfer of financial assets accounted for as a sale. The concept of a qualifying special-purpose entity is no longer applicable. The standard is effective for the first annual reporting period that begins after November 15, 2009, for interim periods within the first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. The Company does not expect the guidance to have any impact on the Company's financial statements. The ASC was amended in December 2009 to include this guidance.

In October 2009, updated guidance was issued to provide for accounting and reporting for own-share lending arrangements issued in contemplation of a convertible debt issuance. At the date of issuance, a share-lending arrangement entered into on an entity's own shares should be measured at fair value in accordance with prior guidance and recognized as an issuance cost, with an offset to additional paid-in capital. Loaned shares are excluded from basic and diluted earnings per share unless default of the shares-lending arrangement occurs. The amendment also requires several disclosures including a description and the terms of the arrangement and the reason for entering into the arrangement. The effective dates of the amendment are dependent upon the date the share-lending arrangement was entered into and include retrospective application for arrangements outstanding as of the beginning of fiscal years beginning on or after December 15, 2009. The Company has no plans to issue convertible debt and, therefore, does not expect the update to have an impact on its financial statements.

In January 2010, guidance was issued to alleviate diversity in the accounting for distributions to shareholders that allowed the shareholder to elect to receive their entire distribution in cash or shares but with a limit on the aggregate amount of cash to be paid. The amendment states that the stock portion of the distribution to shareholders that allows them to elect to receive cash or shares with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance. The amendment is effective for interim and annual periods ending on or after December 15, 2009 and had no impact on the Company's financial statements.

Also in January 2010, an amendment was issued to clarify the scope of subsidiaries for consolidation purposes. The amendment provides that the decrease in ownership guidance should apply to (1) a subsidiary or group of assets that is a business or a nonprofit activity, (2) a subsidiary that is a business or nonprofit activity that is transferred to an equity method investee or joint venture, and (3) an exchange of a group of assets that constitutes a business or nonprofit activity for a noncontrolling interest in an entity. The guidance does not apply to a decrease in ownership in transactions related to sales of in-substance real estate or conveyance of oil or gas mineral rights. The update is effective for the interim or annual reporting periods ending on or after December 15, 2009 and had no impact on the Company's financial statements.

CAROLINA FINANCIAL CORPORATION

FINANCIAL DISCUSSION

Other accounting standards that have been issued 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.

Effect of Inflation and Changing Prices

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles that require the measurement of financial position and results of operations in terms of historical dollars without consideration of changes in the relative purchasing power over time due to inflation.

Unlike many other industries, nearly all assets and liabilities of a financial institution are monetary in nature. Therefore, interest rates usually have a more significant impact on a financial institution's performance than does the effect of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the price of goods and services since such prices are affected by inflation. We are committed to continuing to actively manage the gap between our interest-sensitive assets and interest-sensitive liabilities.



INSERT

INDEPENDENT AUDITOR'S REPORT

CAROLINA FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
DECEMBER 31, 2009 AND 2008

	2009	2008
(In Thousands)		
ASSETS		
Cash and due from banks	\$ 2,901	25,206
Interest-bearing cash	<u>17,759</u>	<u>16,285</u>
Cash and cash equivalents	20,660	41,491
Securities available for sale (cost of \$102,119 and \$125,872 at December 31, 2009 and 2008, respectively)	104,401	120,988
Securities held to maturity (fair value of \$105,450 and \$106,485 at December 31, 2009 and 2008, respectively)	125,633	113,689
Federal Home Loan Bank stock, at cost	12,456	11,874
Other investments	465	465
Derivative assets	2,342	1,999
Loans held for sale	71,233	28,283
Loans receivable, net of allowance for loan losses of \$13,032 and \$11,300 at December 31, 2009 and 2008, respectively	690,163	776,621
Premises and equipment, net	17,443	17,980
Accrued interest receivable	4,550	4,510
Real estate acquired through foreclosure, net	7,853	7,105
Deferred tax assets, net	10,349	9,547
Prepaid FDIC insurance	5,677	-
Other assets	5,532	4,442
Total assets	<u><u>\$ 1,078,757</u></u>	<u><u>1,138,994</u></u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Noninterest-bearing deposits	\$ 37,543	39,952
Interest-bearing deposits	<u>723,565</u>	<u>677,437</u>
Total deposits	761,108	717,389
Short-term borrowed funds	43,787	148,090
Long-term debt	203,638	218,465
Derivative liabilities	891	959
Drafts outstanding	3,117	2,316
Advances from borrowers for insurance and taxes	198	158
Accrued interest payable	1,484	2,764
Accrued expenses and other liabilities	<u>8,396</u>	<u>2,262</u>
Total liabilities	<u><u>1,022,619</u></u>	<u><u>1,092,403</u></u>
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, par value \$.01; 200,000 shares authorized; no shares issued or outstanding at December 31, 2009 and 2008	-	-
Common stock, par value \$.01; 2,800,000 shares authorized; 1,912,492 and 1,912,212 shares issued and outstanding at December 31, 2009 and 2008, respectively	19	19
Additional paid-in capital	21,320	20,925
Retained earnings, restricted	42,433	35,264
Accumulated other comprehensive income (loss), net of tax	<u>(7,634)</u>	<u>(9,617)</u>
Total stockholders' equity	<u><u>56,138</u></u>	<u><u>46,591</u></u>
Total liabilities and stockholders' equity	<u><u>\$ 1,078,757</u></u>	<u><u>1,138,994</u></u>

See accompanying notes to consolidated financial statements.

CAROLINA FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007

	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(In Thousands, Except Per Share Data)		
Interest income			
Loans	\$ 43,892	49,516	60,954
Debt securities	12,786	12,660	3,823
Dividends	39	466	481
Interest-bearing cash	19	407	314
Total interest income	<u>56,736</u>	<u>63,049</u>	<u>65,572</u>
Interest expense			
Deposits	17,781	24,036	28,995
Short-term borrowed funds	1,361	1,998	1,760
Long-term debt	5,877	7,193	6,530
Total interest expense	<u>25,019</u>	<u>33,227</u>	<u>37,285</u>
Net interest income	31,717	29,822	28,287
Provision for loan losses	10,460	6,361	1,775
Net interest income after provision for loan losses	<u>21,257</u>	<u>23,461</u>	<u>26,512</u>
Noninterest income			
Net gain on sale of loans held for sale	23,982	4,579	6,466
Deposit service charges	1,584	1,449	1,075
Income from ATM and debit card transactions	320	308	270
Income from sales of non-depository products	788	867	57
Net loss on extinguishment of debt	(711)	(52)	-
Net gain on sale of available for sale securities	963	952	477
Net loss on other investments	-	(337)	-
Net gain (loss) on sale of real estate acquired through foreclosure	(26)	(55)	35
Net gain (loss) on derivatives	411	1,139	(13)
Other	627	377	502
Total noninterest income	<u>27,938</u>	<u>9,227</u>	<u>8,869</u>
Noninterest expense			
Salaries and employee benefits	20,182	14,497	14,121
Occupancy and equipment	3,413	3,011	2,737
Marketing and public relations	630	655	658
FDIC insurance	2,201	617	466
Expense from ATM and debit card transactions	281	276	227
Other real estate expense	1,843	5	-
Mortgage loan repurchase losses	3,362	285	-
Other	5,761	4,536	4,092
Total noninterest expense	<u>37,673</u>	<u>23,882</u>	<u>22,301</u>
Income before income taxes	11,522	8,806	13,080
Income tax expense	4,353	3,256	4,806
Net income	<u>\$ 7,169</u>	<u>5,550</u>	<u>8,274</u>
Earnings per common share:			
Basic	<u>\$ 3.75</u>	<u>2.95</u>	<u>4.61</u>
Diluted	<u>\$ 3.72</u>	<u>2.83</u>	<u>4.23</u>
Average common shares outstanding:			
Basic	<u>1,912,449</u>	<u>1,883,101</u>	<u>1,794,659</u>
Diluted	<u>1,924,720</u>	<u>1,960,362</u>	<u>1,954,392</u>

See accompanying notes to consolidated financial statements.

CAROLINA FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
AND COMPREHENSIVE INCOME (LOSS)
FOR THE YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount				
	(In Thousands, Except Shares Data)					
Balance, December 31, 2006	1,790,862	\$ 18	19,291	21,440	(90)	40,659
Exercise of stock options	7,400	-	111	-	-	111
Stock-based compensation expense, net	-	-	315	-	-	315
Net income	-	-	-	8,274	-	8,274
Other comprehensive income:						
Unrealized gain on securities, net of tax of \$276	-	-	-	-	479	
Reclassification adjustment for gains included in net income, net of tax of \$174	-	-	-	-	(303)	
Other comprehensive income					176	176
Comprehensive income						8,450
Balance, December 31, 2007	1,798,262	18	19,717	29,714	86	49,535
Exercise of stock options	103,950	1	843	-	-	844
Stock-based compensation expense, net	10,000	-	365	-	-	365
Net income	-	-	-	5,550	-	5,550
Other comprehensive income (loss):						
Unrealized loss on securities, net of tax of \$5,234	-	-	-	-	(9,094)	
Reclassification adjustment for gains included in net income, net of tax of \$343	-	-	-	-	(609)	
Other comprehensive loss					(9,703)	(9,703)
Comprehensive loss						(4,153)
Balance, December 31, 2008	1,912,212	19	20,925	35,264	(9,617)	46,591
Exercise of stock options	280	-	5	-	-	5
Stock-based compensation expense, net	-	-	390	-	-	390
Net income	-	-	-	7,169	-	7,169
Other comprehensive income (loss):						
Unrealized gain on securities, net of tax of \$1,583	-	-	-	-	2,580	
Reclassification adjustment for gains included in net income, net of tax of \$366	-	-	-	-	(597)	
Other comprehensive income					1,983	1,983
Comprehensive income						9,152
Balance, December 31, 2009	<u>1,912,492</u>	<u>\$ 19</u>	<u>21,320</u>	<u>42,433</u>	<u>(7,634)</u>	<u>56,138</u>

See accompanying notes to consolidated financial statements.

CAROLINA FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007

	2009	2008	2007
		(In Thousands)	
Cash flows from operating activities:			
Net income	\$ 7,169	5,550	8,274
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	10,460	6,361	1,775
Deferred tax benefit	(2,019)	(633)	(869)
Amortization of unearned discount/premiums on investments, net	(128)	(212)	(76)
Amortization of deferred loan fees	(604)	(831)	(1,303)
Gain on sale of available for sale securities	(963)	(952)	(477)
Loss on write off of other investments	-	337	-
Gain on sale of loans held for sale	(23,982)	(4,579)	(6,466)
Originations of loans held for sale	(1,700,377)	(712,784)	(949,068)
Proceeds from sale of loans held for sale	1,681,410	714,110	960,893
Loss on extinguishment of debt	711	52	-
Loss (gain) on derivatives	(411)	(1,139)	13
Stock-based compensation	390	365	315
Depreciation	1,254	1,265	1,169
Loss on disposals of premises and equipment	59	20	1
Loss (gain) on sale of real estate acquired through foreclosure	26	55	(35)
Write-down of real estate acquired through foreclosure	1,495	-	-
Decrease (increase) in:			
Accrued interest receivable	(39)	936	18
Other assets	(6,862)	419	259
Increase (decrease) in:			
Accrued interest payable	(1,279)	(420)	1,723
Accrued expenses and other liabilities	6,133	(465)	(1,239)
Net cash (used in) provided by operating activities	<u>(27,557)</u>	<u>7,455</u>	<u>14,907</u>
Cash flows from investing activities:			
Activity in available-for-sale securities:			
Purchases	(64,365)	(175,843)	(123,677)
Maturities, payments and calls	23,759	20,229	6,309
Sales	29,054	64,996	18,834
Activity in held-to-maturity securities:			
Purchases	(4,052)	(3,585)	-
Maturities, payments and calls	24,632	2,829	-
Increase in Federal Home Loan Bank stock	(583)	(1,727)	(4,458)
Decrease in other investments	-	-	48
Decrease (increase) in loans receivable, net	68,092	(50,969)	(78,320)
Purchase of premises and equipment	(807)	(1,104)	(2,158)
Proceeds from disposals of premises and equipment	32	68	-
Proceeds from sale of real estate acquired through foreclosure	6,238	636	1,075
Net cash provided by (used in) investing activities	<u>82,000</u>	<u>(144,470)</u>	<u>(182,347)</u>
Cash flows from financing activities:			
Net increase in deposit accounts	43,719	25,289	69,644
Net (decrease) increase in Federal Home Loan Bank advances	(47,211)	29,199	95,200
Net (decrease) increase in Federal Reserve Bank advances	(91,000)	91,000	-
Net increase (decrease) in other short-term borrowed funds	(2,029)	19,737	2,786
Proceeds from issuance of TLGP debt	20,400	-	-
Proceeds from issuance of subordinated debt	-	3,000	-
Net increase (decrease) in drafts outstanding	802	(3,390)	(5,792)
Net increase in advances from borrowers for insurance and taxes	40	11	15
Proceeds from exercise of stock options	5	844	111
Net cash (used in) provided by financing activities	<u>(75,274)</u>	<u>165,690</u>	<u>161,964</u>
Net increase (decrease) in cash and cash equivalents	<u>(20,831)</u>	<u>28,675</u>	<u>(5,476)</u>
Cash and cash equivalents, beginning of year	<u>41,491</u>	<u>12,816</u>	<u>18,292</u>
Cash and cash equivalents, end of year	<u>\$ 20,660</u>	<u>41,491</u>	<u>12,816</u>

Continued

CAROLINA FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007

	<u>2009</u>	<u>2008</u>	<u>2007</u>
		(In Thousands)	
Supplemental disclosure			
Cash paid for:			
Interest on deposits and borrowed funds	<u>\$ 26,298</u>	<u>33,647</u>	<u>35,562</u>
Income taxes paid, net of refunds	<u>3,666</u>	<u>4,050</u>	<u>6,800</u>
Non-cash investing and financing activities:			
Transfer of loans held for sale to loans receivable	<u>-</u>	<u>-</u>	<u>60</u>
Transfer of loans receivable to real estate acquired through foreclosure	<u>8,507</u>	<u>7,524</u>	<u>668</u>
Transfer of available for sale securities to held to maturity securities	<u>30,597</u>	<u>112,343</u>	<u>-</u>
Unrealized gain (loss) in securities available for sale, net	<u>2,580</u>	<u>(9,094)</u>	<u>479</u>

See accompanying notes to consolidated financial statements.

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Carolina Financial Corporation (“Carolina Financial” or the “Company”), incorporated under the laws of the State of Delaware, is a multi-bank holding company with two wholly owned subsidiary banks, Community FirstBank of Charleston (“Community FirstBank”) and Crescent Bank (together, the “Banks”), and one wholly-owned service corporation, Carolina Services Corporation of Charleston (“Carolina Services”). Effective July 27, 2009, Carolina Financial contributed 100% of its wholly owned mortgage subsidiary Crescent Mortgage Company (“Crescent Mortgage”) to Community FirstBank. The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Community FirstBank, Crescent Bank and Carolina Services. In consolidation, all material intercompany accounts and transactions have been eliminated. The results of operations of the businesses acquired in transactions accounted for as purchases are included only from the dates of acquisition. All majority-owned subsidiaries are consolidated unless control is temporary or does not rest with the Company.

At December 31, 2009 and 2008, statutory business trusts (“Trusts”) created by the Company had outstanding trust preferred securities with an aggregate par value of \$15,000,000. The principal assets of the Trusts are \$15,465,000 of the Company’s subordinated debentures with identical rates of interest and maturities as the trust preferred securities. The Trusts have issued \$465,000 of common securities to the Company and are included in other investments in the accompanying consolidated balance sheets. The Trusts are not consolidated subsidiaries of the Company.

Management’s Estimates

The financial statements are prepared in accordance with generally accepted accounting principles in the United States of America which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, including valuation for impaired loans, the valuation of real estate acquired in connection with foreclosure or in satisfaction of loans, the valuation of securities, the valuation of derivative instruments, the valuation of mortgage servicing rights, the determination of the reserve for mortgage loan repurchase losses, and deferred tax assets or liabilities. In connection with the determination of the allowance for loan losses and foreclosed real estate, management obtains independent appraisals for significant properties. Management must also make estimates in determining the estimated useful lives and methods for depreciating premises and equipment.

While management uses available information to recognize losses on loans and foreclosed real estate, future additions to the allowance may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Banks’ allowances for loan losses and foreclosed real estate. Such agencies may require the Bank to recognize additions to the allowances based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the allowances for loan losses and foreclosed real estate may change materially in the near term.

Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed events occurring through March 5, 2010, the date the financial statements were available to be issued and no subsequent events occurred requiring accrual or disclosure.

Cash and Cash Equivalents

Cash and cash equivalents consists of cash and due from banks and interest-bearing cash with banks. Substantially all of the interest-bearing cash at December 31, 2009 and 2008 is Federal Home Loan Bank overnight deposits. Cash and cash equivalents have maturities of three months or less. Accordingly, the carrying amount of such instruments is considered a reasonable estimate of fair value. The Banks are required to maintain average balances on hand or with the Federal Reserve Bank. At December 31, 2009 and 2008, these reserve balances amounted to \$1,259,000 and \$1,736,000, respectively.

Securities

Investment securities are classified into three categories: (a) Held to Maturity – debt securities that the Company has positive intent and ability to hold to maturity, which are reported at amortized cost; (b) Trading – debt and equity securities that are bought and held principally for the purpose of selling them in the near term, which are reported at fair value, with unrealized gains and losses included in earnings; and (c) Available for Sale – debt and equity securities that may be sold under certain conditions, which are reported at fair value, with unrealized gains and losses excluded from earnings and reported in accumulated other comprehensive income as a separate component of stockholders’ equity, net of income taxes.

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

The Company determines investment and mortgage-backed securities classification at the time of purchase. If a security is transferred from available for sale to held to maturity, the fair value at the time of transfer becomes the held to maturity security's new cost basis. Premiums and discounts on securities are accreted and amortized as an adjustment to interest yield over the estimated life of the security using a method which approximates a level yield. Dividends and interest income are recognized when earned. Unrealized losses on securities, reflecting a decline in value judged by the Company to be other than temporary, are charged to income in the consolidated statements of operations.

The cost basis of securities sold is determined by specific identification. Purchases and sales of securities are recorded on a trade date basis.

Loans Held for Sale

The Company's residential mortgage lending activities for sale in the secondary market are comprised of accepting residential mortgage loan applications, qualifying borrowers to standards established by investors, funding residential mortgage loans and selling mortgage loans to investors under pre-existing commitments. Funded residential mortgages held for sale to investors are reported at the lower of aggregate cost or estimated fair value. Net unrealized losses, if any, are recognized in a valuation allowance by charges to operations. Gains or losses realized on the sales of loans are recognized at the time of sale and are determined by the difference between the net sales proceeds and the carrying value of the loans sold, adjusted for any servicing asset or liability retained. Gains and losses on sales of loans are included in noninterest income.

The Company issues rate lock commitments to borrowers on prices quoted by secondary market investors. Derivatives related to these commitments are recorded as either assets or liabilities in the balance sheet and are measured at fair value. Changes in the fair value of the derivatives are reported in current earnings or other comprehensive income depending on the purpose for which the derivative is held and whether the derivative qualifies for hedge accounting. The Company does not currently engage in any activities that qualify for hedge accounting. Accordingly, changes in fair values of these derivative instruments are included in noninterest income in the consolidated statements of operations.

Loans Receivable, Net

Loans that management has the intent and ability to hold for the foreseeable future are reported at their outstanding principal balances net of any unearned income, charge-offs, deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans. The net amount of nonrefundable loan origination fees, commitment fees and certain direct costs associated with the lending process are deferred and amortized to interest income over the contractual lives of the loans using methods which approximate a level yield. Discounts and premiums on purchased loans are amortized to interest income over the estimated life of the loans using methods that approximate a level yield. Commercial loans and substantially all installment loans accrue interest on the unpaid balance of the loans.

A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral-dependent. When the fair value of the impaired loan is less than the recorded investment in the loan, the impairment is recorded through a specific reserve allocation that is a component of the allowance for loan losses. A loan is charged-off against the allowance for loan losses when all meaningful collection efforts have been exhausted and the loan is viewed as uncollectible in the immediate or foreseeable future.

Loan origination and commitment fees, net of related costs are amortized in interest income over the contractual life of the loan using a method that approximates the level yield method, adjusted for prepayments, or noninterest income when the loan is sold.

Mortgage Servicing Rights, Fees and Costs

The Company initially measures servicing assets and liabilities retained related to the sale of residential loans held for sale ("mortgage servicing rights") at fair value, if practicable. For subsequent measurement purposes, the Company measures servicing assets and liabilities based on the lower of cost or market.

Mortgage servicing rights are amortized in proportion to, and over the period of, estimated net servicing income. The amortization of the mortgage servicing rights is analyzed periodically and is adjusted to reflect changes in prepayment rates and other estimates.

The Company evaluates potential impairment of mortgage servicing rights based on the difference between the carrying amount and current estimated fair value of the servicing rights. In determining impairment, the Company aggregates all servicing rights and stratifies them into tranches based on predominant risk characteristics of interest rate, loan type and investor type. If impairment exists, a valuation allowance is established for any excess of amortized cost over the current estimated fair value by a charge to income. If the Company later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income.

Service fee income is recorded for fees earned for servicing mortgage loans under servicing agreements with the Federal National Mortgage Association ("FNMA"), the Federal Home Loan Mortgage Corporation ("FHLMC") and certain private investors. The fees are based on a

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

contractual percentage of the outstanding principal balance of the loans serviced and are recorded as income when received. The amortization of mortgage servicing rights is netted against loan servicing fee income. Mortgage servicing costs are charged to expense when incurred.

Nonperforming Assets

Nonperforming assets include loans on which interest is not being accrued, accruing loans that are 90 days or more delinquent and foreclosed property. Foreclosed property consists of real estate and other assets acquired as a result of a borrower's loan default. Loans are generally placed on nonaccrual status when concern exists that principal or interest is not fully collectible, or when any portion of principal or interest becomes 90 days past due, whichever occurs first. Loans past due 90 days or more may remain on accrual status if management determines that concern over the collectibility of principal and interest is not significant. When loans are placed on nonaccrual status, interest receivable is reversed against interest income in the current period. Interest payments received thereafter are applied as a reduction to the remaining principal balance as long as concern exists as to the ultimate collection of the principal. Loans are removed from nonaccrual status when they become current as to both principal and interest and when concern no longer exists as to the collectibility of principal or interest.

Assets acquired as a result of foreclosure are carried at the lower of cost or fair value less estimated selling costs. If cost exceeds fair value less estimated selling costs at the time of foreclosure, the asset is written down to fair value less estimated selling costs with the difference being charged against the allowance for loan losses. Generally, such properties are appraised annually, and the carrying value, if greater than the fair value less estimated selling costs, is adjusted with a charge to noninterest expense. Routine maintenance costs and declines in market value are included in noninterest expense. Net gains or losses on sale are included in noninterest income.

Allowance for Loan Losses

The allowance for loan losses is Management's estimate of probable credit losses inherent in the loan portfolio at the balance sheet date. Management determines the allowance based on an ongoing evaluation. This evaluation is inherently subjective because it requires material estimates and is based on evaluations of the collectibility of loans. Impaired loans, including nonaccrual loans, loans past due 90 or more days and still accruing, troubled-debt restructured loans, and loans in excess of a defined threshold that are not paying in accordance with contractual terms, are evaluated for specific impairment. The specific reserves are determined on a loan-by-loan basis based on Management's evaluation of the Company's exposure for each credit, given the current payment status of the loan and the value of any underlying collateral. Management's estimate of losses in the remainder of the portfolio is based on certain observable data that Management believes are most reflective of the underlying credit losses being estimated. This evaluation includes credit quality trends; collateral values; portfolio aging; loan volumes; geographic, borrower and industry concentrations; seasoning of the loan portfolio; the findings of internal credit quality assessments and results from external bank regulatory examinations.

While Management uses the best information available to establish the allowance for loan losses, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the valuations or, if required by regulators, based upon information available to them at the time of their examinations. Such adjustments to original estimates, as necessary, are made in the period in which these factors and other relevant considerations indicate that loss levels may vary from previous estimates.

Guarantees

Standby letters of credit obligate the Company to meet certain financial obligations of its customers, under the contractual terms of the agreement, if the customers are unable to do so. Payment is only guaranteed under these letters of credit upon the borrower's failure to perform its obligations to the beneficiary. The Company can seek recovery of the amounts paid from the borrower; however, these standby letters of credit are generally not collateralized. Commitments under standby letters of credit are usually one year or less. At December 31, 2009, the Company had recorded no liability for the current carrying amount of the obligation to perform as a guarantor; as such amounts are not considered material. The maximum potential amount of undiscounted future payments related to standby letters of credit at December 31, 2009 was \$910,000.

Premises and Equipment, Net

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the asset's estimated useful life. Estimated lives range up to forty years for buildings and improvements and up to ten years for furniture, fixtures and equipment. Maintenance and repairs are charged to expense as incurred. Improvements that extend the lives of the respective assets are capitalized. When property or equipment is sold or otherwise disposed of, the cost and related accumulated depreciation are removed from the respective accounts and the resulting gain or loss is reflected in income.

Advertising

The Company expenses advertising costs as incurred.

Income Taxes

The provision for income taxes is based upon income before taxes for financial statement purposes, adjusted for nontaxable income and nondeductible expenses. Deferred income taxes have been provided when different accounting methods have been used in determining income for income tax purposes and for financial reporting purposes. Deferred tax assets and liabilities are recognized based on future tax

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

consequences attributable to differences arising from the financial statement carrying values of assets and liabilities and their tax bases. In the event of changes in the tax laws, deferred tax assets and liabilities are adjusted in the period of the enactment of those changes, with the cumulative effects included in the current year's income tax provision.

Positions taken by the Company's tax returns may be subject to challenge by the taxing authorities upon examination. The benefit of uncertain tax positions are initially recognized in the financial statements only when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions are both initially and subsequently measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon settlement with the tax authority, assuming full knowledge of the position and all relevant facts. The Company believes that its income tax filing positions taken or expected to be taken in its tax returns will more likely than not be sustained upon audit by the taxing authorities and does not anticipate any adjustments that will result in a material adverse impact on the Company's financial condition, results of operations, or cash flow. Therefore, no reserves for uncertain tax positions have been recorded.

Interest and penalties on income tax uncertainties are classified within income tax expense in the income statement. The Company had no interest or penalties during fiscal 2009, 2008 and 2007.

Drafts Outstanding

The Company invests excess funds on deposit at other banks (including amounts on deposit for payment of outstanding disbursement checks) on a daily basis in an overnight interest-bearing account. Accordingly, outstanding checks are reported as a liability.

Reserve for Mortgage Loan Repurchase Losses

The Company sells mortgage loans to various third parties, including government-sponsored entities, under contractual provisions that include various representations and warranties that typically cover ownership of the loan, compliance with loan criteria set forth in the applicable agreement, validity of the lien securing the loan, absence of delinquent taxes or liens against the property securing the loan, and similar matters. The Company may be required to repurchase the mortgage loans with identified defects, indemnify the investor or insurer, or reimburse the investor for credit loss incurred on the loan (collectively "repurchase") in the event of a material breach of such contractual representations or warranties. Risk associated with potential repurchases or other forms of settlement is managed through underwriting and quality assurance practices and by servicing mortgage loans to meet investor and secondary market standards.

The Company establishes mortgage repurchase reserves related to various representations and warranties that reflect management's estimate of losses based on a combination of factors. Such factors incorporate estimated levels of defects on internal quality assurance, default expectations, historical investor repurchase demand and appeals success rates, reimbursement by correspondent and other third party originators, and projected loss severity. The Company establishes a reserve at the time loans are sold and continually updates the reserve estimate during the estimated loan life. The reserve for repurchases, included in Accrued expenses and other liabilities in the accompanying consolidated statements of financial condition, was \$3.0 million at December 31, 2009 and \$183,000 at December 31, 2008.

To the extent that economic conditions and the housing market do not recover or future investor repurchase demand and appeals success rates differ from past experience, the Company could continue to have increased demands and increased loss severities on repurchases, causing future additions to the repurchase reserve.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Comprehensive Income

Comprehensive income consists of net income and net unrealized gains (losses) on securities and is presented in the consolidated statements of changes in stockholders' equity and comprehensive income. The Company's other comprehensive income for the years ended December 31, 2009, 2008 and 2007 and accumulated other comprehensive income as of December 31, 2009 and 2008 are comprised solely of unrealized gains (losses) on certain investment securities.

Off-Balance-Sheet Financial Instruments

In the ordinary course of business, the Company entered into off-balance-sheet financial instruments consisting of commitments to extend credit, commitments under revolving credit agreements, and standby letters of credit. Such financial instruments are recorded in the financial statements when they are funded.

Stock-Based Compensation

At December 31, 2009, the Company had three stock-based payment plans for directors, officers and other key employees, which are described below.

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

The fair value at the date of grant of the stock option is estimated using the Black-Scholes option-pricing model based on assumptions noted in a table below. The dividend yield is based on estimated future dividend yields. The risk-free rate for periods within the contractual term of the share option is based on the U.S. Treasury yield curve in effect at the time of grant. Expected volatilities are generally based on historical volatilities. The expected term of share options granted is generally derived from historical experience. Compensation expense is recognized on a straight-line basis over the stock option vesting period. The expense recognition of employee awards resulted in net expense of approximately \$390,000, \$365,000 and \$315,000 during the twelve months ended December 31, 2009, 2008 and 2007, respectively.

The Company adopted the 2006 Recognition and Retention Plan under which an aggregate of 60,000 shares have been reserved for issuance by the Company upon the grant of non-vested common stock. The plan provides for the grant of stock to key employees and Directors of the Company and its subsidiaries. The non-vested common stock vests ratably over a five-year period. During 2008, 10,000 shares of non-vested common stock of the Company were granted to a key employee of the Company at \$37.57 per share. As of December 31, 2009, 50,000 shares have been awarded under the plan, of which 26,000 shares have vested. At December 31, 2009, 24,000 shares are unvested.

Additionally, the Company has adopted the 1998 Stock Option Plan and the 2002 Stock Option Plan under which an aggregate of 7,590 shares and 138,750 shares, respectively, have been reserved for issuance by the Company upon the grant of stock options or limited rights. The plans provide for the grant of options to key employees and Directors as determined by a Stock Option Committee. The options vest ratably over a five-year period and have a ten-year term, both of which begin at the date of grant. The aggregate options available and the option exercise prices have been adjusted to reflect the issuance of a 15% stock dividend during 1998 and the issuance of a 10% stock dividend during 2000.

A summary of the status of the Company's stock option plans at December 31, 2009, 2008 and 2007 and changes during the years then ended is presented below:

	2009		2008		2007	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	145,760	\$ 15.86	249,990	\$ 12.67	257,590	\$ 12.74
Granted	-	-	-	-	-	-
Exercised	(280)	17.57	(103,950)	8.12	(7,400)	15.00
Forfeited or expired	(500)	24.00	(280)	38.50	(200)	15.00
Outstanding at end of year	144,980	\$ 15.83	145,760	\$ 15.86	249,990	\$ 12.67
Options exercisable at end of year	142,920	\$ 15.63	141,050	\$ 15.49	242,450	\$ 12.23

The following table summarizes information about the options outstanding at December 31, 2009:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Avg. Remaining Years Contractual Life	Weighted Average Exercise Price	Number Outstanding	Weighted Average Exercise Price
\$ 15.00 to \$20.00	137,090	2.4	\$ 15.15	137,090	\$ 15.15
\$ 20.00 to \$25.00	5,840	5.5	24.00	4,600	24.00
\$ 35.00 to \$40.00	2,050	6.8	38.50	1,230	38.50
	144,980	2.6	\$ 15.83	142,920	\$ 15.63

There were no options granted during the years ended December 31, 2009, 2008 and 2007. The total intrinsic value of options exercised during the twelve months ended December 31, 2009, 2008 and 2007 was \$2,000, \$246,000, and \$32,000, respectively.

Fair values have been retroactively restated for all stock dividends since the date the option was granted. As of December 31, 2009, there was approximately \$751,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements. Unrecognized cost is projected to be recognized over a weighted average period of approximately two years.

The Company generally issues authorized but previously unissued shares to satisfy option exercises.

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Reclassification

Certain reclassifications of accounts reported for previous periods have been made in these consolidated financial statements. Such reclassifications had no effect on stockholders' equity or the net income as previously reported.

Recently Adopted Accounting Standards

The following is a summary of recent authoritative pronouncements that could impact the accounting, reporting, and disclosure of financial information by the Company.

In June 2009, the Financial Accounting Standards Board ("FASB") issued guidance that restructured generally accepted accounting principles ("GAAP") and simplified access to all authoritative literature by providing a single source of authoritative nongovernmental GAAP. The guidance is presented in a topically organized structure referred to as the FASB Accounting Standards Codification ("ASC"). The new structure is effective for interim or annual periods ending after September 15, 2009. All existing accounting standards have been superseded and all other accounting literature not included is considered nonauthoritative.

The FASB issued new accounting guidance on accounting for transfer of financial assets in June 2009. The guidance limits the circumstances in which a financial asset should be derecognized when the transferor has not transferred the entire financial asset by taking into consideration the transferor's continuing involvement. The standard requires that a transferor recognize and initially measure at fair value all assets obtained (including a transferor's beneficial interest) and liabilities incurred as a result of a transfer of financial assets accounted for as a sale. The concept of a qualifying special-purpose entity is no longer applicable. The standard is effective for the first annual reporting period that begins after November 15, 2009, for interim periods within the first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. The Company does not expect the guidance to have any impact on the Company's financial statements. The ASC was amended in December 2009 to include this guidance.

In October 2009, updated guidance was issued to provide for accounting and reporting for own-share lending arrangements issued in contemplation of a convertible debt issuance. At the date of issuance, a share-lending arrangement entered into on an entity's own shares should be measured at fair value in accordance with prior guidance and recognized as an issuance cost, with an offset to additional paid-in capital. Loaned shares are excluded from basic and diluted earnings per share unless default of the shares-lending arrangement occurs. The amendment also requires several disclosures including a description and the terms of the arrangement and the reason for entering into the arrangement. The effective dates of the amendment are dependent upon the date the share-lending arrangement was entered into and include retrospective application for arrangements outstanding as of the beginning of fiscal years beginning on or after December 15, 2009. The Company has no plans to issue convertible debt and, therefore, does not expect the update to have an impact on its financial statements.

In January 2010, guidance was issued to alleviate diversity in the accounting for distributions to shareholders that allowed the shareholder to elect to receive their entire distribution in cash or shares but with a limit on the aggregate amount of cash to be paid. The amendment states that the stock portion of the distribution to shareholders that allows them to elect to receive cash or shares with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance. The amendment is effective for interim and annual periods ending on or after December 15, 2009 and had no impact on the Company's financial statements.

Also in January 2010, an amendment was issued to clarify the scope of subsidiaries for consolidation purposes. The amendment provides that the decrease in ownership guidance should apply to (1) a subsidiary or group of assets that is a business or a nonprofit activity, (2) a subsidiary that is a business or nonprofit activity that is transferred to an equity method investee or joint venture, and (3) an exchange of a group of assets that constitutes a business or nonprofit activity for a noncontrolling interest in an entity. The guidance does not apply to a decrease in ownership in transactions related to sales of in-substance real estate or conveyance of oil or gas mineral rights. The update is effective for the interim or annual reporting periods ending on or after December 15, 2009 and had no impact on the Company's financial statements.

Other accounting standards that have been issued 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.

Risks and Uncertainties

In the normal course of its business, the Company encounters two significant types of risks: economic and regulatory. There are three main components of economic risk: interest rate risk, credit risk, and market risk. The Company is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different speeds, or on a different basis, than its interest-earning assets. Credit risk is the risk of default on the loan portfolio or certain securities that results from borrowers' inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of collateral underlying loans receivable and the valuation of real estate held by the Company.

The Company is subject to the regulations of various governmental agencies. These regulations can and do change significantly from period to period. Periodic examinations by the regulatory agencies may subject the Company to further changes with respect to asset

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

valuations, amounts of required loss allowances and operating restrictions from the regulators' judgments based on information available to them at the time of their examination.

NOTE 2 - SECURITIES

The amortized cost, gross unrealized gains, gross unrealized losses and fair value of investments securities available for sale and held to maturity at December 31, 2009 and 2008 follows:

	2009			2008				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available for sale:	(In Thousands)							
GNMA	\$ 4,088	29	-	4,117	-	-	-	-
Mortgage-backed securities	98,031	2,661	(408)	100,284	108,565	1,252	(2,345)	107,472
Asset-backed securities	-	-	-	-	17,307	-	(3,791)	13,516
Total securities available for sale	\$ 102,119	2,690	(408)	104,401	125,872	1,252	(6,136)	120,988
Securities held to maturity:								
Mortgage-backed securities	\$ 111,660	1,144	(13,552)	99,252	111,940	918	(8,062)	104,796
Asset-backed securities	13,973	-	(7,775)	6,198	1,749	-	(60)	1,689
Total securities held to maturity	\$ 125,633	1,144	(21,327)	105,450	113,689	918	(8,122)	106,485

The amortized cost and fair value of debt securities by contractual maturity at December 31, 2009 follows:

	Amortized Cost	Fair Value
	(In Thousands)	
Securities available for sale:		
One year to five years	\$ 4,135	4,137
Six to ten years	3,358	3,448
After ten years	94,626	96,816
Total	\$ 102,119	104,401
Securities held to maturity:		
Six to ten years	\$ 404	415
After ten years	125,229	105,035
Total	\$ 125,633	105,450

The contractual maturity dates of the securities was used for mortgage-backed securities and asset-backed securities. No estimates were made to anticipate principal repayments.

The gross unrealized losses and fair value of the Company's investments available for sale with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2009 are as follows:

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

	Less than 12 Months			12 Months or Greater			Total		
	Amortized Cost	Fair Value	Unrealized Losses	Amortized Cost	Fair Value	Unrealized Losses	Amortized Cost	Fair Value	Unrealized Losses
Securities available for sale:	(In Thousands)								
Mortgage-backed securities	\$ 19,847	19,451	(396)	2,531	2,519	(12)	22,378	21,970	(408)
Securities held to maturity:									
Mortgage-backed securities	\$ 23,228	18,146	(5,082)	70,489	62,019	(8,470)	93,717	80,165	(13,552)
Asset-backed securities	-	-	-	13,973	6,198	(7,775)	13,973	6,198	(7,775)
Total	\$ 23,228	18,146	(5,082)	84,462	68,217	(16,245)	107,690	86,363	(21,327)

The gross unrealized losses and fair value of the Company's investments available for sale and held to maturity with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2008 are as follows:

	Less than 12 Months			12 Months or Greater			Total		
	Amortized Cost	Fair Value	Unrealized Losses	Amortized Cost	Fair Value	Unrealized Losses	Amortized Cost	Fair Value	Unrealized Losses
Securities available for sale:	(In Thousands)								
Mortgage-backed securities	\$ 10,306	9,913	(393)	27,230	25,278	(1,952)	37,536	35,191	(2,345)
Asset-backed securities	6,011	4,899	(1,112)	10,288	7,609	(2,679)	16,299	12,508	(3,791)
Total	\$ 16,317	14,812	(1,505)	37,518	32,887	(4,631)	53,835	47,699	(6,136)
Securities held to maturity:									
Mortgage-backed securities	\$ 62,535	55,195	(7,340)	27,666	26,944	(722)	90,201	82,139	(8,062)
Asset-backed securities	-	-	-	1,749	1,689	(60)	1,749	1,689	(60)
Total	\$ 62,535	55,195	(7,340)	29,415	28,633	(782)	91,950	83,828	(8,122)

At December 31, 2009 and 2008, the Company had 14 and 42, respectively, individual investments available for sale that were in an unrealized loss position. The unrealized losses on the Company's investments in mortgage-backed securities and asset-backed securities summarized above were attributable primarily to credit quality, credit rating changes and liquidity. Management has performed various analyses, including cash flows, and believes that the securities are not other-than-temporarily impaired at December 31, 2009. The Company does not intend to sell these securities and it is more likely than not that the Company will not be required to sell these securities before recovery of their amortized cost.

The Banks, as members of the Federal Home Loan Bank ("FHLB") of Atlanta, are required to own capital stock in the FHLB of Atlanta based generally upon a membership-based requirement and an activity based requirement. FHLB capital stock is pledged to secure FHLB advances. No secondary market exists for this stock, and it has no quoted market price. However, redemption through the FHLB of this stock has historically been at par value. The Company's investment in FHLB capital stock was \$12.5 million and \$11.9 million at December 31, 2009 and 2008, respectively.

Other investments at December 31, 2009 and 2008 consisted of \$465,000 invested in capital stock of statutory business trusts (See Note 10 – Long-term debt).

NOTE 3 – DERIVATIVES

The derivative positions of the Company at December 31, 2009 and 2008 are as follows:

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

	2009		2008	
	Fair Value	Notional Value	Fair Value	Notional Value
	(In Thousands)			
Derivative assets -				
Mortgage loan interest rate lock commitments	\$ 428	46,588	1,999	222,994
Forward mortgage loan sales commitments	1,914	130,000	-	-
	\$ 2,342		1,999	
Derivative liabilities -				
Forward mortgage loan sales commitments	\$ 891	177,282	959	121,000

NOTE 4 - LOANS RECEIVABLE, NET

Loans receivable, net at December 31, 2009 and 2008 are summarized by category as follows:

	2009	2008
	(In Thousands)	
Residential mortgage	\$ 53,094	57,682
Commercial mortgage	301,344	322,595
Construction mortgage	14,639	66,279
Commercial loans	284,889	312,099
Consumer loans	72,917	80,993
Total loans	726,883	839,648
Less:		
Undisbursed loans in process	23,230	51,000
Allowance for loan losses	13,032	11,300
Deferred fees, net	458	727
	36,720	63,027
Loans receivable, net	\$ 690,163	776,621

The composition of gross loans outstanding, net of undisbursed amounts, by rate type is as follows:

	2009	2008
	(In Thousands)	
Variable rate loans	\$ 456,128	583,103
Fixed rate loans	247,525	205,545
Total gross loans	\$ 703,653	788,648

Activity in the allowance for loan losses for the years ended December 31, 2009 and 2008 are as follows:

	2009	2008	2007
	(In Thousands)		
Balance at beginning of year	\$ 11,300	10,083	8,406
Provision for loan losses	10,460	6,361	1,775
Charge-offs	(9,442)	(5,190)	(243)
Recoveries	714	46	145
Balance at end of year	\$ 13,032	11,300	10,083

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

The following is a summary of information pertaining to impaired and nonaccrual loans at December 31:

	<u>2009</u>	<u>2008</u>
	(In Thousands)	
Impaired loans without a valuation allowance	\$ 45,735	8,802
Impaired loans with a valuation allowance	23,244	6,708
Total impaired loans	<u>\$ 68,979</u>	<u>15,510</u>
Valuation allowance related to impaired loans	\$ 3,827	1,180
Average of impaired loans during the year	44,393	19,932
Total nonaccrual loans	27,059	13,923
Total loans past due 90 days and still accruing interest	771	13

Substantially all of the non-accrual loans, accruing loans 90 days or more delinquent and accruing renegotiated loans for fiscal 2009 and 2008 are collateralized by real estate. Management believes based on information known and available currently, the probable losses related to problem assets are adequately reserved in the allowance for loan losses.

The company recognized interest income of \$4,000, \$0 and \$0 on loans that are past due 90 days and still accruing during the year ended December 31, 2009, 2008 and 2007, respectively. The Company had \$8.9 million and \$1.1 million of restructured loans as of December 31, 2009 and 2008, respectively.

Loans serviced for the benefit of others under loan participation arrangements amounted to approximately \$32,443,000 and \$35,112,000 at December 31, 2009 and 2008, respectively.

Activity in loans to officers, directors and other related parties for the years ended December 31, 2009 and 2008 is summarized as follows:

	<u>2009</u>	<u>2008</u>
	(In Thousands)	
Balance at beginning of year	\$ 20,584	18,586
New loans	9,044	9,951
Repayments	<u>(8,271)</u>	<u>(7,953)</u>
Balance at end of year	<u>\$ 21,357</u>	<u>20,584</u>

In management's opinion, related party loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with an unrelated person and generally do not involve more than the normal risk of collectibility.

In the normal course of business, to meet the financing needs of its customers, the Company is a party to financial instruments with off-balance-sheet risk. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet.

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

Commitments to extend credit are agreements to lend as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation.

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

NOTE 5 - PREMISES AND EQUIPMENT, NET

Premises and equipment, net at December 31, 2009 and 2008 consists of the following:

	<u>2009</u>	<u>2008</u>
	(In Thousands)	
Land	\$ 5,040	5,040
Buildings	11,277	11,277
Furniture, fixtures and equipment	7,123	7,023
Construction in process	<u>25</u>	<u>25</u>
Total premises and equipment	23,465	23,365
Less: accumulated depreciation	<u>(6,022)</u>	<u>(5,385)</u>
Premises and equipment, net	<u>\$ 17,443</u>	<u>17,980</u>

Depreciation expense included in operating expenses for the years ended December 31, 2009, 2008 and 2007 amounted to \$1.2 million, \$1.3 million, and \$1.2 million, respectively. There was no interest capitalized during fiscal 2009 and 2008.

NOTE 6 – REAL ESTATE ACQUIRED THROUGH FORECLOSURE

Transactions in other real estate owned for the years ended December 31, 2009 and 2008 are summarized below:

	<u>2009</u>	<u>2008</u>
	(In Thousands)	
Balance, beginning of year	\$ 7,105	272
Additions	8,507	7,524
Sales	(6,264)	(691)
Write downs	<u>(1,495)</u>	<u>-</u>
Balance, end of year	<u>\$ 7,853</u>	<u>7,105</u>

NOTE 7 – MORTGAGE SERVICING RIGHTS

Mortgage loans serviced for others are not included in the accompanying statement of financial condition. The value of mortgage servicing rights is included in other assets on the Company's statement of financial condition. The unpaid principal balances of loans serviced for others were \$282.5 million and \$45.3 million, respectively, at December 31, 2009 and 2008.

The estimated fair values of mortgage servicing rights were \$3.1 million and \$250,000, respectively, at December 31, 2009 and 2008. The estimated fair value of servicing rights at December 31, 2009 were determined using discount rates ranging from 9.50% to 17.29%, prepayment speed assumptions ("PSA") ranging from 135.5 to 423.6, depending upon the stratification of the specific right, and a weighted average delinquency rate of 3.89% as determined by a third party. The estimated fair value of servicing rights at December 31, 2008 were determined using discount rates ranging from 10.0% to 20.81%, prepayment speed assumptions ("PSA") ranging from 194 to 1,455, depending upon the stratification of the specific right, and a weighted average delinquency rate of 4.23% as determined by a third party.

The following summarizes the activity in mortgage servicing rights, along with the aggregate activity in the related valuation allowances, for the years ended December 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
	(In Thousands)	
MSR beginning balance	\$ 250	310
Amount capitalized	1,717	118
Amount amortized	(275)	(103)
Recovery (provision) for loss in fair value	105	(75)
MSR ending balance	<u>\$ 1,797</u>	<u>250</u>

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Activity in the allowance for loss in fair value in mortgage servicing rights for the years ended December 31, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
	(In Thousands)	
Balance at beginning of year	\$ 105	30
Provision for loss in fair value	-	75
Impairment recoveries	(105)	-
Balance at end of year	<u>\$ -</u>	<u>105</u>

The estimated amortization expense for mortgage servicing rights for the years ended December 31, 2010, 2011, 2012, 2013, 2014 and thereafter is \$235,000, \$215,000, \$190,000, \$165,000, \$144,000 and \$848,000, respectively. The estimated amortization expense is based on current information regarding loan payments and prepayments. Amortization expense could change in future periods based on changes in the volume of prepayments and economic factors.

At December 31, 2009 and 2008, servicing related trust funds of approximately \$401,000 and \$489,000, respectively, representing both principal and interest due investors and escrows received from borrowers, are on deposit in affiliated trust bank custodial accounts and are included in noninterest-bearing deposits in the accompanying financial statements. At December 31, 2009 and 2008, the Company had blanket bond coverage of \$5.0 million and errors and omissions coverage of \$5.0 million.

NOTE 8 - DEPOSITS

Deposits outstanding by type of account at December 31, 2009 and 2008 are summarized as follows:

	<u>2009</u>	<u>2008</u>
	(In Thousands)	
Noninterest-bearing demand accounts	\$ 37,543	39,952
Interest-bearing demand accounts	31,710	24,902
Savings accounts	2,824	2,252
Money market accounts	155,019	81,451
Certificates of deposit		
1.00% to 2.99%	465,140	181,576
3.00% to 4.99%	67,389	385,464
5.00% to 7.99%	1,483	1,792
Total certificates of deposit	<u>534,012</u>	<u>568,832</u>
Total deposits	<u>\$ 761,108</u>	<u>717,389</u>

The aggregate amount of certificates of deposit, excluding brokered deposits, with a minimum denomination of \$100,000 was \$118.9 million and \$141.3 million at December 31, 2009 and 2008, respectively. The aggregate amount of brokered certificates of deposit was \$115.7 million and \$246.0 million at December 31, 2009 and 2008, respectively.

The amounts and scheduled maturities of certificates of deposit at December 31, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
	(In Thousands)	
Maturing within one year	\$ 425,397	521,394
Maturing one through three years	105,422	46,633
Maturing after three years	3,193	805
	<u>\$ 534,012</u>	<u>568,832</u>

The Company has pledged \$11.8 million of U.S. government agencies and corporations' securities available for sale as of December 31, 2009 to secure public agency funds.

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

NOTE 9 – SHORT-TERM BORROWED FUNDS

Short-term borrowed funds at December 31, 2009 and 2008 are summarized as follows:

	2009		2008	
	Balance	Interest Rate	Balance	Interest Rate
	(In Thousands)			
Unsecured line of credit	\$ 3,000	4.75%	3,000	2.75%
Short-term FHLB advances	21,500	0.36%-2.715%	33,000	0.00% - 4.38%
Short-term FRB advances	-	-	91,000	0.50%
Mortgage loan warehouse line of credit	19,062	5.25%-8.50%	21,090	3.48%
Subordinated debenture, due 2020	225	2.75%	-	-
Total short-term borrowed funds	\$ 43,787		148,090	

Lines of credit with the Federal Home Loan Bank of Atlanta are based upon FHLB approved percentages of Bank assets, but must be supported by appropriate collateral to be available. The Banks have pledged approximately \$177.8 million first lien residential mortgage, second lien residential mortgage, residential home equity line of credit, commercial mortgage and multifamily mortgage portfolios under a blanket lien agreement as collateral to the FHLB for these advances. In addition, the Company has pledged \$59.8 million of securities for these advances. At December 31, 2009, the Banks had maximum FHLB lines of \$339.1 million based on FHLB limits. At December 31, 2009, the Banks pledged collateral totaling \$237.6 million to support FHLB advances. At December 31, 2009 the Banks had FHLB advances of \$176.5 million outstanding, with excess collateral pledged to the FHLB that would support additional borrowings of approximately \$61.0 million.

Lines of credit with the FRB are based on collateral pledged. The Banks pledged \$139.9 million of non-mortgage commercial, acquisition and development, and lot loan portfolios under blanket lien agreements as collateral to the FRB for these advances. At December 31, 2009 the Banks had lines available with the FRB for \$71.5 million. At December 31, 2009 the Banks had no FRB advances outstanding.

The mortgage loan warehouse line of credit is an extension of credit facility to Crescent Mortgage with a \$35.0 million credit limit, of which \$15.9 million is still available. The facility is secured by certain Crescent Mortgage's residential mortgage loans held for sale and its other assets.

The Company has \$3.0 million outstanding on an unsecured line of credit with a correspondent bank. See Note 10 – Long-Term Debt for additional disclosure.

The Company has a subordinated debenture totaling \$3.0 million that has principal repayments beginning in 2010. See Note 10 – Long-Term Debt for additional disclosure.

In addition, the Banks had \$11.2 million available under federal funds purchase line agreements with correspondent banks.

NOTE 10 – LONG-TERM DEBT

Long-term debt at December 31, 2009 and 2008 are summarized as follows:

	December 31, 2009	
	Balance	Interest Rate
	(In Thousands)	
Long-term FHLB advances, due 2011 through 2021	\$ 155,000	0.00% - 4.23%
TLGP, due 2012	20,398	2.74%
Subordinated debentures, due 2016 through 2020	12,775	1.78% - 2.75%
Subordinated debentures issued to Carolina Financial Capital Trust I, due 2032	5,155	3.75%
Subordinated debentures issued to Carolina Financial Capital Trust II, due 2034	10,310	3.33%
Total long-term debt	\$ 203,638	

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

	December 31, 2008	
	Balance	Interest Rate
	(In Thousands)	
Long-term FHLB advances, due 2010 through 2021	\$ 190,000	1.40% - 4.23%
Subordinated debentures, due 2016 through 2020	13,000	6.21% - 6.32%
Subordinated debentures issued to Carolina Financial Capital Trust I, due 2032	5,155	5.50%
Subordinated debentures issued to Carolina Financial Capital Trust II, due 2034	10,310	7.80%
Total long-term debt	\$ 218,465	

As of December 31, 2009, the principal amounts due on long-term debt in 2010, 2011, 2012, 2013, 2014 and thereafter were \$0, \$42.8 million, \$43.2 million, \$20.3 million, \$5.3 million and \$92.1 million, respectively. As of December 31, 2009, the principal amounts callable by the FHLB on advances in 2010, 2011, 2012, 2013, 2014 and thereafter were \$12.5 million, \$55.0 million, \$5.0 million, \$5.0 million, and \$0, respectively.

During 2009 the Company issued \$20.4 million of indebtedness under the Federal Deposit Insurance Corporation's ("FDIC") Temporary Liquidity Guarantee Program ("TLGP"). The FDIC guarantees the debt until its maturity in 2012.

At December 31, 2009 and 2008, statutory business trusts ("Trusts") created by the Company had outstanding trust preferred securities with an aggregate par value of \$15.0 million. The trust preferred securities have floating interest rates ranging from 5.50% to 7.80% at December 31, 2009 and maturities ranging from December 31, 2032 to January 7, 2034. The principal assets of the Trusts are \$15.5 million of the Company's subordinated debentures with identical rates of interest and maturities as the trust preferred securities. The Trusts have issued \$465,000 of common securities to the Company.

The trust preferred securities, the assets of the Trusts and the common securities issued by the Trusts are redeemable in whole or in part beginning on or after December 31, 2008, or at any time in whole but not in part from the date of issuance on the occurrence of certain events. The obligations of the Company with respect to the issuance of the trust preferred securities constitutes a full and unconditional guarantee by the Company of the Trusts' obligations with respect to the trust preferred securities. Subject to certain exceptions and limitations, the Company may elect from time to time to defer subordinated debenture interest payments, which would result in a deferral of distribution payments on the related trust preferred securities.

As currently defined by the Federal Reserve Board, the Company had \$15.0 million of long-term debt that qualified as Tier 1 capital at December 31, 2009 and 2008. The Company had \$12.2 million and \$13.0 million of long-term debt that qualified as Tier 2 capital at December 31, 2009 and 2008, respectively.

During 2008, the Company modified a \$5.0 million unsecured line of credit with a correspondent bank, of which \$3.0 million is outstanding at December 31, 2009, to be extended to March 31, 2020. In connection with this modification, the Company obtained a \$3.0 million subordinated debenture that, as a condition to the line of credit modification, requires the Company to keep at least a \$500,000 principal balance outstanding on the line of credit until the subordinated debenture is paid in full. If the Company does not maintain the \$500,000 balance, there is a \$150,000 prepayment penalty. During 2009, the Company has maintained at least a \$500,000 principal balance outstanding on the line of credit. During 2009, the correspondent bank was put into receivership with the FDIC. As a result, the undrawn \$2 million of availability under this unsecured line of credit has been withdrawn by the FDIC. The line of credit also has debt covenants, the more restrictive of which requires the Company to maintain certain capital ratios and return on asset ratios. As of December 31, 2009, the Company is not in compliance with all of the covenants. While the lender has not called the line of credit, it has the right to do so. Accordingly, the Company has developed alternatives to replace this line of credit, if necessary, by obtaining financing from other sources, raising capital or by receiving dividends from its subsidiaries to pay off the debt. As a result, management does not believe that default of this covenant will have a material adverse affect on the Company's financial condition or the results of its operations.

NOTE 11 - INCOME TAXES

Deferred tax assets are recognized for future deductible amounts resulting from differences in the financial statement and tax bases of assets and liabilities and operating loss carryforwards. A valuation allowance is then established to reduce that deferred tax asset to the level that it is "more likely than not" that the tax benefit will be realized. The realization of a deferred tax benefit by the Company depends upon having sufficient taxable income of an appropriate character in the future periods.

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Income tax expense for the years ended December 31, 2009, 2008 and 2007 consists of the following:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Current income tax expense		(In Thousands)	
Federal	\$ 5,776	3,565	5,210
State	596	324	465
	<u>6,372</u>	<u>3,889</u>	<u>5,675</u>
Deferred income tax expense (benefit)			
Federal	(2,248)	(551)	(801)
State	229	(82)	(68)
	<u>(2,019)</u>	<u>(633)</u>	<u>(869)</u>
Total income tax expense	<u>\$ 4,353</u>	<u>3,256</u>	<u>4,806</u>

A reconciliation from expected Federal tax expense to actual income tax expense for the years ended December 31, 2009, 2008 and 2007, using the base federal tax rates of 35%, 34% and 35%, respectively, is as follows:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
		(In Thousands)	
Computed federal income taxes	\$ 4,033	2,994	4,578
State income tax, net of federal benefit	311	300	262
Change in valuation allowance	(38)	43	38
Other, net	47	(81)	(72)
Total income tax expense	<u>\$ 4,353</u>	<u>3,256</u>	<u>4,806</u>

The following is a summary of the tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities at December 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Deferred tax assets:		(In Thousands)
Loan loss reserve	\$ 4,431	4,071
Loan fees	157	240
Unrealized loss on securities available for sale	4,417	5,528
Tax vs. book gain on loans held for sale	26	50
Debt issuance costs	101	106
Net operating loss carryforwards	106	203
Reserve for mortgage loan buy-back	1,031	62
OREO write-downs	353	-
Securities yield adjustments	230	-
Other	218	92
	<u>11,070</u>	<u>10,352</u>
Valuation allowance	<u>(106)</u>	<u>(203)</u>
Total gross deferred tax assets	<u>10,964</u>	<u>10,149</u>
Deferred tax liabilities:		
Depreciation	(360)	(102)
Stock-based compensation	(123)	(254)
Short-term disability accrual	(132)	(246)
Total gross deferred tax liabilities	<u>(615)</u>	<u>(602)</u>
Deferred tax assets, net	<u>\$ 10,349</u>	<u>9,547</u>

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

A portion of the annual change in the net deferred income tax asset relates to unrealized gains and losses on debt and equity securities. The related 2009 and 2008 deferred income tax benefit of \$2.1 million and \$5.6 million, respectively, was recorded directly to stockholders' equity as a component of accumulated other comprehensive income. The balance of the 2009 and 2008 change in the net deferred tax asset of \$2.0 million and \$633,000, respectively, is reflected as a deferred income tax benefit in the consolidated statement of operations.

The 2009 and 2008 valuation allowances related to state net operating loss carryforwards. It is management's belief that the realization of the remaining net deferred tax assets is more likely than not.

At December 31, 2009, income tax returns from 2008, 2007 and 2006 remain subject to review by tax authorities.

NOTE 12 - COMMITMENTS AND CONTINGENCIES

The Company has entered into agreements to lease its office facilities under noncancellable operating lease agreements expiring on various dates through June 2020. The Company's rental expense for its office facilities for the years ended December 31, 2009, 2008 and 2007 totaled \$807,000, \$524,000 and \$507,000, respectively. Minimum rental commitments (in thousands) under the leases are as follows:

2010	\$	517
2011		482
2012		495
2013		507
2014		339
Thereafter		<u>292</u>
Total	\$	<u><u>2,632</u></u>

NOTE 13 – ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS

Current accounting literature requires disclosures about the fair value of all financial instruments whether or not recognized in the balance sheet, for which it is practicable to estimate the value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized through immediate settlement of the instrument. Certain items are specifically excluded from disclosure requirements, including the Company's stock, premises and equipment, accrued interest receivable and payable and other assets and liabilities.

The fair value of a financial instrument is an amount at which the asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced sale. Fair values estimates are made at a specific point in time based on relevant market information and information about the financial instruments. Because no market value exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors.

The Company has used Management's best estimate of fair value based on the above assumptions. Thus the fair values presented may not be the amounts that could be realized in an immediate sale or settlement of the instrument. In addition, any income taxes or other expenses that would be incurred in an actual sale or settlement are not taken into consideration in the fair values presented.

Cash and due from banks - The carrying amount of these financial instruments approximate fair value. All mature within 90 days and present no anticipated credit concerns.

Interest-bearing cash - The carrying amount of these financial instruments approximate fair value.

Securities available for sale and securities held to maturity – Fair values for investment securities available for sale and securities held to maturity are based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions.

Federal Home Loan Bank stock and other non-marketable equity securities - The carrying amount of these financial instruments approximate fair value.

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Derivative assets – Fair values are based on quoted market prices, where available. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable instruments.

Loans held for sale and loans receivable, net - For variable-rate loans that reprice frequently and have no significant change in credit risk, estimated fair values are based on carrying values. Estimated fair values for certain mortgage loans, credit card loans, and other consumer loans are based on quoted market prices of similar loans sold in conjunction with securitization transactions, adjusted for differences in loan characteristics. Estimated fair values for commercial real estate and commercial loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Estimated fair values for impaired loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Accrued interest receivable - The fair value approximates the carrying value.

Deposits - The estimated fair value of demand deposits, savings accounts, and money market accounts is the amount payable on demand at the reporting date. The estimated fair value of fixed-maturity certificates of deposits is estimated by discounting the future cash flows using rates currently offered for deposits of similar remaining maturities.

Short-term borrowed funds - The carrying amounts of federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings maturing within 90 days approximate their fair values. Estimated fair values of other short-term borrowings are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Long-term debt - The estimated fair values of the Company's long-term debt are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Derivative liabilities - Fair values are based on quoted market prices, where available. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable instruments.

Commitments to extend credit – The carrying amount of these commitments is considered to be a reasonable estimate of fair value because the commitments underlying interest rates are based upon current market rates.

Accrued interest payable - The fair value approximates the carrying value.

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

The carrying amount and estimated fair value of the Company's financial instruments at December 31, 2009 and 2008 are as follows:

	2009		2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:	(In Thousands)			
Cash and due from banks	\$ 2,901	2,901	25,206	25,206
Interest-bearing cash	17,759	17,759	16,285	16,285
Securities available for sale	104,401	104,401	120,988	120,988
Securities held to maturity	125,633	105,450	113,689	106,485
Federal Home Loan Bank stock	12,456	12,456	11,874	11,874
Other investments	465	465	465	465
Derivative assets	2,342	2,342	1,999	1,999
Loans held for sale	71,233	71,682	28,283	28,823
Loans receivable, net	690,163	699,069	776,621	766,178
Accrued interest receivable	4,550	4,550	4,510	4,510
Financial liabilities:				
Deposits	761,108	731,567	717,389	721,736
Short-term borrowed funds	43,787	45,599	148,090	148,095
Long-term debt	203,638	209,359	218,465	230,856
Derivative liabilities	891	891	959	959
Accrued interest payable	1,484	1,484	2,764	2,764
Off-Balance Sheet Financial Instruments:				
Commitments to extend credit	\$ 50,100	\$ -	85,100	-
Standby letters of credit	\$ 910	\$ -	3,400	-

In determining appropriate levels, the Company performs a detailed analysis of the assets and liabilities that are subject to fair value disclosures. At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs are classified as Level 3.

Assets and liabilities that are carried at fair value are classified in one of the following three categories based on a hierarchy for ranking the quality and reliability of the information used to determine fair value:

- Level 1 Quoted prices in active markets for identical assets or liabilities.
- Level 2 Observable market based inputs or unobservable inputs that are corroborated by market data.
- Level 3 Unobservable inputs that are not corroborated by market data.

Assets and liabilities measured at fair value on a recurring basis are as follows as of December 31, 2009 and 2008:

	Quoted market price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
December 31, 2009			
Available-for-sale investment securities	\$ -	4,117	-
Mortgage-backed securities	-	100,284	-
Asset-back securities	-	-	-
Total	\$ -	104,401	-
December 31, 2008			
Available-for-sale investment securities	\$ -	-	-
Mortgage-backed securities	-	107,472	-
Asset-back securities	-	13,516	-
Total	\$ -	120,988	-

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Assets measured at fair value on a nonrecurring basis are as follows as of December 31, 2009 and 2008:

	Quoted market price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
December 31, 2009			
Impaired loans	\$ -	68,979	-
Real estated owned	-	7,853	-
Total	<u>\$ -</u>	<u>76,832</u>	<u>-</u>
December 31, 2008			
Impaired loans	\$ -	15,510	-
Real estated owned	-	7,105	-
Total	<u>\$ -</u>	<u>22,615</u>	<u>-</u>

The Company predominantly lends with real estate serving as collateral on a substantial majority of loans. Loans that are deemed to be impaired are primarily valued at fair values of the underlying real estate collateral.

NOTE 14 - OFF-BALANCE SHEET FINANCIAL INSTRUMENTS AND CONCENTRATIONS OF CREDIT RISK

The Company is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheets.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of these instruments. The Company uses the same credit policies in making commitments as for on-balance sheet instruments. At December 31, 2009 and 2008, the Banks had commitments to extend credit in the amount of \$50.1 million and \$85.1 million, respectively. At December 31, 2009 and 2008, the Banks had standby letters of credit in the amount of \$910,000 and \$3.4 million, respectively.

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

Standby letters of credit obligate the Company to meet certain financial obligations of its customers, if, under the contractual terms of the agreement, the customers are unable to do so. Payment is only guaranteed under these letters of credit upon the borrower's failure to perform its obligations to the beneficiary. The Company can seek recovery of the amounts paid from the borrower and the letters of credit are generally not collateralized. Commitments under standby letters of credit are usually one year or less. At December 31, 2009, the Company has recorded no liability for the current carrying amount of the obligation to perform as a guarantor; as such amounts are not considered material. The maximum potential of undiscounted future payments related to standby letters of credit at December 31, 2009 was approximately \$910,000.

The Company uses derivatives primarily to neutralize interest rate risk related to its pipeline of interest rate lock commitments issued on residential mortgage loans in the process of origination for sale. At December 31, 2009 and 2008, the Company's outstanding mortgage interest rate lock commitments totaled \$223.9 million and \$223.0 million, respectively. The Company uses forward mortgage loan sales commitments that generally correspond with the composition of the locked pipeline to hedge a percentage of the Company's pipeline of mortgage loan interest rate lock commitments and loans held for sale. At December 31, 2009 and 2008, the Company's outstanding forward mortgage loan sales commitments totaled \$130.0 million and \$121.0 million, respectively. The Company's derivative positions are marked to market as shown in Note 3 - Derivatives.

Management closely monitors its credit concentrations and attempts to diversify the portfolio within its market area. The Company's markets are concentrated along coastal South Carolina. At December 31, 2009, the Company has approximately \$612.9 million of commercial real estate loan exposure.

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

NOTE 15 - EMPLOYEE BENEFIT PLANS

The Company maintains a 401(k) plan that covers substantially all employees of Community FirstBank, Crescent Bank, and Carolina Services ("CFC participants"). During 2004, the Company added Crescent Mortgage ("CMC Participants") as a separate group that participated in the plan. Participants may contribute up to the maximum allowed by the regulation. During 2008, and 2007 the Company matched 75% of an employee's contribution up to 6.00% of the participant's compensation of the CFC Participants and matched 50% of an employee's contribution up to 4.00% of the participant's compensation of the CMC Participants. During 2009, the Company matched 75% of an employee's contribution up to 6.00% of the participant's compensation of the CFC Participants and the CMC Participants. For the years ended December 31, 2009, 2008 and 2007, the Company made matching contributions of \$370,000, \$289,000 and \$290,000, respectively.

The Company has an arrangement with four executives whereby the Company paid a lump sum payment to an insurance company on behalf of the executives. The advance is treated as a loan to the executives and the cash surrender value of the payment to the insurance company is included in other assets in the accompanying consolidated statements of financial condition. The cash surrender value of the advance at December 31, 2009 and 2008 is \$1.6 million and \$1.7 million, respectively. The executives are entitled to the increase in cash value above the Company's original cash value insurance contributions. The executives pay the Company imputed interest on the loan balance and the increase in the cash value is recorded as compensation to the executives. The insurance policy premiums are paid in full by the executives. Generally, each executive is entitled to receive a \$1.0 million death benefit and the Company will receive a \$1.8 million death benefit. Since the executives pay the insurance premiums, the insurance proceeds will be taxable to the Company.

NOTE 16 - EARNINGS PER SHARE

Basic earnings per share is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by dividing net income by the weighted average number of common shares outstanding plus the weighted average number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. Diluted earnings per share include the effects of outstanding stock options issued by the Company if dilutive. The number of additional shares is calculated by assuming that outstanding stock options were exercised and that the proceeds from such exercises were used to acquire shares of common stock at the average market price during the reporting period.

The following is a summary of the reconciliation of average shares outstanding for the years ended December 31, 2009, 2008 and 2007:

	2009		2008		2007	
	Basic	Diluted	Basic	Diluted	Basic	Diluted
Weighted average shares outstanding	1,912,449	1,912,449	1,883,101	1,883,101	1,794,659	1,794,659
Effect of dilutive securities:						
Stock options	-	12,271	-	77,261	-	159,733
Average shares outstanding	<u>1,912,449</u>	<u>1,924,720</u>	<u>1,883,101</u>	<u>1,960,362</u>	<u>1,794,659</u>	<u>1,954,392</u>

The average market price used in calculating the dilutive securities under the treasury stock method for the years ended December 31, 2009, 2008 and 2007 was \$17.53, \$44.92 and \$50.40, respectively. For fiscal 2009, 42,703 option shares were excluded from the calculation of diluted earnings per share at some time during the period because the exercise prices were greater than the average market price of the common shares, and therefore would have been anti-dilutive. For fiscal years 2008 and 2007, there were no options excluded from the calculation of diluted earnings per share. The Company does not have an actively traded market for its shares and, accordingly, the average market price used in calculating dilutive securities is based on a very limited number of transactions.

NOTE 17 - CAPITAL REQUIREMENTS AND OTHER RESTRICTIONS

The Company and the Banks are subject to various federal and state regulatory requirements, including regulatory capital requirements. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions that if undertaken could have a direct material effect on the Company's and the Banks' financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Banks must meet specific capital guidelines that involve quantitative measures of the Company's and the Banks' assets, liabilities, and certain off-balance sheet items as calculated under regulatory methods. The Company's and the Banks' capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weighting and other factors. As of December 31, 2009, the most recent notification from federal banking agencies categorized the Company and the Banks as "well capitalized" under the regulatory framework. In order to be considered "adequately capitalized", the Company and the Banks are required to maintain minimum Tier 1 capital and total risk based capital to risk weighted assets and Tier 1 capital to total average assets of 4%, 8%, and 3%, respectively. In order to be considered "well capitalized", the Company and the Banks are required to maintain minimum Tier 1 capital and total risk based capital to risk weighted assets and Tier 1 capital to total

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

average assets of 6%, 10%, and 5%, respectively. Since December 31, 2009, there have been no events or conditions that management believes have changed the Company's or the Banks' regulatory capital categories.

The actual capital amounts and ratios for the Company and the Banks at December 31, 2009 and 2008 are as follows:

	2009		2008	
	Amount	Ratio	Amount	Ratio
	(Dollars In Thousands)			
Carolina Financial Corporation				
Tier 1 capital (to risk weighted assets)	\$ 78,773	9.2%	71,208	8.4%
Total risk based capital (to risk weighted assets)	101,696	11.9%	94,780	11.2%
Tier 1 capital (to total avg assets)	78,773	7.3%	71,208	6.4%
Community FirstBank				
Tier 1 capital (to risk weighted assets)	45,166	10.4%	36,590	8.9%
Total risk based capital (to risk weighted assets)	55,633	12.8%	46,754	11.3%
Tier 1 capital (to total avg assets)	45,166	7.7%	36,590	6.6%
Crescent Bank				
Tier 1 capital (to risk weighted assets)	35,404	8.4%	33,806	8.1%
Total risk based capital (to risk weighted assets)	47,849	11.4%	47,027	11.3%
Tier 1 capital (to total avg assets)	35,404	7.2%	33,806	6.3%

Any future dividend payments by the Company will be made primarily from dividends received from the Banks and Crescent Mortgage. Under applicable federal law, the Banks are restricted to total dividend payments in any calendar year to net profits of that year combined with retained net profits for the two preceding years. At December 31, 2009, the Banks had \$18.0 million of retained net profits free of such restriction.

NOTE 18 – SUPPLEMENTAL SEGMENT INFORMATION

The Company has three reportable segments: community banking, mortgage banking and other. The community banking segment provides traditional banking services offered through Community FirstBank and Crescent Bank. The mortgage banking segment provides mortgage loan origination and servicing offered through Crescent Mortgage. The other segment provides managerial and operational support to the other business segments through Carolina Services and Carolina Financial.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance based on net income.

The Company accounts for intersegment revenues and expenses as if the revenue/expense transactions were to third parties, that is, at current market prices.

The Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each segment has different types and levels of credit and interest rate risk.

The following tables present selected financial information for the Company's reportable business segments for the years ended December 31, 2009, 2008 and 2007 (In Thousands):

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

For the Year Ended December 31, 2009	Community Banking	Mortgage Banking	Other	Eliminations	Total
Interest income	\$ 55,296	1,431	23	(14)	56,736
Interest expense	23,283	1,037	713	(14)	25,019
Net interest income (expense)	32,013	394	(690)	-	31,717
Provision for loan losses	10,460	-	-	-	10,460
Noninterest income from external customers	4,014	23,924	-	-	27,938
Intersegment noninterest income	-	-	4,422	(4,422)	-
Noninterest expense	18,038	14,211	5,424	-	37,673
Intersegment noninterest expense	3,840	582	-	(4,422)	-
Income (loss) before income taxes	3,689	9,525	(1,692)	-	11,522
Income tax expense (benefit)	1,348	3,594	(589)	-	4,353
Net income (loss)	<u>\$ 2,341</u>	<u>5,931</u>	<u>(1,103)</u>	<u>-</u>	<u>7,169</u>
Assets	\$ 1,051,233	35,607	83,753	(91,836)	1,078,757
Loans receivable, net	690,563	-	-	(400)	690,163
Loans held for sale	43,412	27,821	-	-	71,233
Deposits	763,538	-	-	(2,430)	761,108
Borrowed funds	209,899	19,062	18,865	(401)	247,425
For the Year Ended December 31, 2008	Community Banking	Mortgage Banking	Other	Eliminations	Total
Interest income	\$ 62,064	960	72	(47)	63,049
Interest expense	31,488	539	1,247	(47)	33,227
Net interest income	30,576	421	(1,175)	-	29,822
Provision for loan losses	6,361	-	-	-	6,361
Noninterest income (expense) from external customers	4,304	5,260	(337)	-	9,227
Intersegment noninterest income	-	-	4,536	(4,536)	-
Noninterest expense	14,186	4,939	4,757	-	23,882
Intersegment noninterest expense	3,780	756	-	(4,536)	-
Income (loss) before income taxes	10,553	(14)	(1,733)	-	8,806
Income tax expense (benefit)	3,853	(5)	(592)	-	3,256
Net income (loss)	<u>\$ 6,700</u>	<u>(9)</u>	<u>(1,141)</u>	<u>-</u>	<u>5,550</u>
Assets	\$ 1,111,268	26,827	76,520	(75,621)	1,138,994
Loans receivable, net	776,802	156	-	(337)	776,621
Loans held for sale	6,684	21,599	-	-	28,283
Deposits	719,655	-	-	(2,266)	717,389
Borrowed funds	327,001	21,090	18,802	(338)	366,555

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

For the Year Ended December 31, 2007	Community Banking	Mortgage Banking	Other	Eliminations	Total
Interest income	\$ 65,042	468	120	(58)	65,572
Interest expense	35,332	365	1,646	(58)	37,285
Net interest income (expense)	29,710	103	(1,526)	-	28,287
Provision for loan losses	1,775	-	-	-	1,775
Noninterest income from external customers	3,495	5,374	-	-	8,869
Intersegment noninterest income	-	-	4,296	(4,296)	-
Noninterest expense	12,902	5,129	4,270	-	22,301
Intersegment noninterest expense	3,924	372	-	(4,296)	-
Income (loss) before income taxes	14,604	(24)	(1,500)	-	13,080
Income tax expense (benefit)	5,329	(8)	(515)	-	4,806
Net income (loss)	\$ 9,275	(16)	(985)	-	8,274
Assets	\$ 970,440	5,969	70,206	(69,476)	977,139
Loans receivable, net	738,638	404	-	(337)	738,705
Loans held for sale	22,361	2,669	-	-	25,030
Deposits	693,780	-	-	(1,680)	692,100
Borrowed funds	203,751	1,353	18,802	(338)	223,568

NOTE 19 - PARENT COMPANY FINANCIAL INFORMATION

The condensed financial statements for the parent company are presented below:

Carolina Financial Corporation
Condensed Statements of Financial Condition
December 31, 2009 and 2008

	2009	2008
Assets:		
	(In Thousands)	
Cash and cash equivalents	\$ 895	747
Investment in bank subsidiaries	72,627	60,779
Investment in non-bank subsidiaries	372	3,681
Investment in unconsolidated statutory business trusts	465	465
Securities available for sale	502	-
Other assets	127	6
Total assets	<u>74,988</u>	<u>65,678</u>
Liabilities and stockholders' equity:		
Accrued expenses and other liabilities	385	622
Short-term debt	3,000	3,000
Long-term debt	15,465	15,465
Stockholders' equity	56,138	46,591
Total liabilities and stockholders' equity	<u>\$ 74,988</u>	<u>65,678</u>

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

Carolina Financial Corporation
Condensed Statements of Operations
For the Years Ended December 31, 2009, 2008 and 2007

	<u>2009</u>	<u>2008</u>	<u>2007</u>
		(In Thousands)	
Dividend income from bank subsidiaries	\$ 900	-	1,500
Dividend income from non-bank subsidiaries	1,000	-	150
Interest income	23	40	58
Other income	126	300	372
Total income	<u>2,049</u>	<u>340</u>	<u>2,080</u>
Interest expense	704	1,210	1,607
General and administrative expenses	805	755	666
Total expenses	<u>1,509</u>	<u>1,965</u>	<u>2,273</u>
Loss before income taxes and equity in undistributed earnings of subsidiaries	540	(1,625)	(193)
Income tax benefit	(464)	(552)	(643)
Income (loss) before equity in undistributed earnings of subsidiaries	<u>1,004</u>	<u>(1,073)</u>	<u>450</u>
Equity in undistributed earnings of Community FirstBank	1,894	3,108	3,410
Equity in undistributed earnings of Crescent Bank	1,598	3,592	4,366
Equity in undistributed earnings (losses) of Crescent Mortgage	2,881	(9)	(16)
Equity in undistributed (losses) earnings of Carolina Services	(208)	(68)	64
Total equity in undistributed earnings of subsidiaries	<u>6,165</u>	<u>6,623</u>	<u>7,824</u>
Net income	<u>\$ 7,169</u>	<u>5,550</u>	<u>8,274</u>

Carolina Financial Corporation
Condensed Statements of Cash Flows
For the Years Ended December 31, 2009, 2008 and 2007

	<u>2009</u>	<u>2008</u>	<u>2007</u>
		(In Thousands)	
Cash flows from operating activities:			
Net income	\$ 7,169	5,550	8,274
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Equity in undistributed earnings in subsidiaries	(6,165)	(6,623)	(7,824)
Stock-based compensation	390	365	315
(Increase) decrease in other assets	(8)	39	93
Increase (decrease) in other liabilities	(508)	(111)	340
Net cash provided by (used in) operating activities	<u>878</u>	<u>(780)</u>	<u>1,198</u>
Cash flows from investing activities:			
Purchase of securities available for sale	(35)	-	-
Equity investment in bank subsidiaries	(700)	-	(3,000)
Net cash used in financing activities	<u>(735)</u>	<u>-</u>	<u>(3,000)</u>
Cash flows from financing activities:			
Proceeds from issuance of short-term borrowed funds	-	-	2,000
Proceeds from exercise of stock options	5	844	111
Net cash provided by financing activities	<u>5</u>	<u>844</u>	<u>2,111</u>
Net increase (decrease) in cash and cash equivalents	<u>148</u>	<u>64</u>	<u>309</u>
Cash and cash equivalents, beginning of year	<u>747</u>	<u>683</u>	<u>374</u>
Cash and cash equivalents, end of year	<u>\$ 895</u>	<u>747</u>	<u>683</u>

CAROLINA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009 AND 2008

NOTE 20 – QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The tables below represent the quarterly results of operations for the years ending December 31, 2009, 2008 and 2007 respectively:

	2009			
	First	Second	Third	Fourth
	(In Thousands, Except Per Share Data)			
Total interest income	\$ 14,587	14,458	14,039	13,652
Total interest expense	6,992	6,626	5,950	5,451
Net interest income	7,595	7,832	8,089	8,201
Provision for loan losses	1,661	2,206	2,516	4,077
Net interest income after provision for loan losses	5,934	5,626	5,573	4,124
Noninterest income	5,354	8,469	5,624	8,491
Noninterest expense	7,901	10,097	9,049	10,626
Income before taxes	3,387	3,998	2,148	1,989
Income tax expense	1,249	1,525	813	766
Net income	\$ 2,138	2,473	1,335	1,223
Basic earnings per share	\$ 1.12	1.29	0.70	0.64
Diluted earnings per share	\$ 1.12	1.29	0.70	0.61

	2008			
	First	Second	Third	Fourth
	(In Thousands, Except Per Share Data)			
Total interest income	\$ 16,694	15,612	15,401	15,342
Total interest expense	9,476	8,311	7,725	7,715
Net interest income	7,218	7,301	7,676	7,627
Provision for loan losses	1,280	607	1,524	2,950
Net interest income after provision for loan losses	5,938	6,694	6,152	4,677
Noninterest income	3,192	2,473	1,713	1,849
Noninterest expense	6,227	6,488	5,152	6,015
Income before taxes	2,903	2,679	2,713	511
Income tax expense	1,068	979	1,012	197
Net income	\$ 1,835	1,700	1,701	314
Basic earnings per share	\$ 1.01	0.89	0.89	0.16
Diluted earnings per share	\$ 0.94	0.87	0.86	0.16

	2007			
	First	Second	Third	Fourth
	(In Thousands, Except Per Share Data)			
Total interest income	\$ 15,371	16,598	17,210	16,393
Total interest expense	8,584	9,293	9,751	9,657
Net interest income	6,787	7,305	7,459	6,736
Provision for loan losses	380	445	270	680
Net interest income after provision for loan losses	6,407	6,860	7,189	6,056
Noninterest income	1,969	2,267	2,245	2,388
Noninterest expense	5,205	5,548	5,908	5,640
Income before taxes	3,171	3,579	3,526	2,804
Income tax expense	1,166	1,311	1,297	1,032
Net income	\$ 2,005	2,268	2,229	1,772
Basic earnings per share	\$ 1.12	1.26	1.24	0.99
Diluted earnings per share	\$ 1.02	1.16	1.14	0.91

CAROLINA FINANCIAL CORPORATION

CAROLINA FINANCIAL CORPORATION

OFFICERS

John D. Russ
President and Chief Executive Officer

David L. Morrow
Executive Vice President

William A. Gehman, III
Vice President and Controller

Frank J. Cole, Jr.
Executive Vice President, Secretary and Chief Financial Officer

M. J. Huggins, III
Executive Vice President and Assistant Secretary

Jerry L. Rexroad
Executive Vice President

BOARD OF DIRECTORS

William H. Alford
Vice President and Secretary
A & I, Inc.

Robert G. Clawson, Jr., Esq.
Member
Clawson and Staubes, LLC

G. Manly Eubank
Chairman
Palmetto Ford, Inc.

Frank E. Lucas
Chairman
LS3P Associates, LTD

Benedict P. Rosen
Retired
AVX Corporation

Bonum S. Wilson, Jr.
Venture Capitalist

Howell (Skeets) V. Bellamy, Jr.
Member
Bellamy, Rutenberg, Copeland, Epps,
Gravelly & Bowers, P.A.

Frank J. Cole, Jr.
Executive Vice President, Secretary and
Chief Financial Officer
Carolina Financial Corporation

M. J. Huggins, III
President and Secretary
Crescent Bank

Robert M. Moïse, CPA, CVA
Partner
WebsterRogers, LLP

John D. Russ
President and Chief Executive Officer
Carolina Financial Corporation

W. Scott Brandon
President
The Brandon Agency

Jeffery L. Deal, M.D.
Founding Member, Charleston ENT
(Retired)
Director of Health Services
Water Missions International

Robert C. KenKnight
Retired
Crescent Mortgage Company

David L. Morrow
Chief Executive Officer
Community FirstBank and
Crescent Bank

Lt. Gen. Claudius E. Watts, III
Chairman
(USAF – Retired)
Past President, The Citadel

CAROLINA FINANCIAL CORPORATION

COMMUNITY FIRSTBANK

OFFICERS

John D. Russ
Chairman

Gail A. Brown
Vice President
Senior Consumer Lender

Andrew J. DeMasi
Vice President
Commercial Banking

William A. Gehman III
Vice President and Controller

Richard Pierce
Vice President and Branch Manager
Meeting Street

Robert L. Tennyson
Vice President
Commercial Banking

David L. Morrow
Chief Executive Officer

Ellen M. Cavanaugh
Vice President
Loan Administration

Doug Driggers
Vice President and Branch Manager
West Ashley

Harold E. Jervey, III
Executive Vice President
Business Development

Leon G. Runey
Vice President
Commercial Banking

Robert H. Warrick
Senior Vice President
Senior Credit Officer

Frank J. Cole, Jr.
President, Treasurer, Secretary and
Chief Financial Officer

A. Taylor Clarkson, III
Senior Vice President
Summerville City Executive

Mary D. Garcia
Senior Vice President
Senior Commercial Lender

Linda H. Kennedy
Vice President
Commercial Banking

Barbara W. Schoppe
Vice President
West Ashley

Elizabeth D. Williams
Vice President and Branch Manager
Summerville

BOARD OF DIRECTORS

Robert G. Clawson, Jr., Esq.
Member
Clawson and Staubes, LLC

G. Manly Eubank
Chairman
Palmetto Ford, Inc.

David L. Morrow
Chief Executive Officer
Community FirstBank and Crescent Bank

Lt. General Claudius E. Watts, III
(USAF – Retired)
Past President
The Citadel

Frank J. Cole, Jr.
Executive Vice President, Secretary and
Chief Financial Officer
Carolina Financial Corporation

Frank E. Lucas
Chairman
LS3P Associates, LTD

John D. Russ
Chairman
President and Chief Executive Officer
Carolina Financial Corporation

Bonum S. Wilson, Jr.
Venture Capitalist

Jeffery L. Deal, M.D.
Founding Member, Charleston ENT (Retired)
Director of Health Services
Water Missions International

Robert M. Moïse, CPA, CVA
Partner
WebsterRogers, LLP

John M. Settle
Vice Chairman

SUMMERVILLE ADVISORY BOARD

Dr. Ron Givens
Partner
Lowcountry Women's Specialists

Dr. Robert S. Randall
Member
Dental Associates of Summerville, LLC

Jack Kersting
President
Mr. K's Piggly Wiggly

Jan Waring-Woods
Partner
Dixon, Hughes PLLC

Johnny Linton
Special Counsel
Duffy & Young

CAROLINA FINANCIAL CORPORATION

CRESCENT BANK

OFFICERS

David L. Morrow
Chief Executive Officer

Jean E. Chestnut
Vice President

Charles J. Fehlig, Jr.
Executive Vice President

G. Timothy Hoag
Vice President

F. Ross Rankin
Senior Vice President

M. J. Huggins, III
President and Secretary

Marshall K. Cooper
Vice President

William A. Gehman
Vice President and Controller

Frederick W. Jasper, Jr.
Senior Vice President

M. Wayne Staton
Senior Vice President

Frank J. Cole, Jr.
*Executive Vice President and
Chief Financial Officer*

Michael L. Evans
Vice President

E. Hayden Hamilton, Jr.
Vice President

Travis A. Minter
Senior Vice President

BOARD OF DIRECTORS

William H. Alford
*Vice President and Secretary
A & I, Inc.*

Mary Eleanor Eaddy
*President
The Wordsmith, Inc.
Special Asst. to the President of CCU*

Daniel W. R. Moore, Sr.
*President
DM Development Co., Inc.*

Benedict P. Rosen
Chairman
*Retired
AVX Corporation*

Howell (Skeets) V. Bellamy, Jr.
*Member
Bellamy, Rutenberg, Copeland, Epps,
Gravelly & Bowers, P.A.*

M. J. Huggins, III
*President and Secretary
Crescent Bank*

David L. Morrow
*Chief Executive Officer
Community FirstBank and Crescent Bank*

Steve C. Taylor
*President
Native Sons Screenprinting and Embroidery*

W. Scott Brandon
Vice Chairman
*President
The Brandon Agency*

Daniel H. Isaac, Jr.
*President
A & I, Inc.*

Edward L. Proctor, Jr., M.D.
*Partner
Diagnostic Pathology, P.A.*

Advisory Boards

North Myrtle Beach

Dr. Robert DeGrood
President – Southern Surgical, P.A.

John Harrison
Retired Executive, Exxon Corporation

Jacqui Isbil
Owner – Umberto's at Coquina Harbor

Dr. Garnett Ramsbottom
*President – North Myrtle Beach Family
Practice*

Ray E. Skidmore, Jr.
President – Fox Fire Communities

Dr. William T. Davis
Carolina Family Dental, PA

Conway

Joseph O. Burroughs, Jr.
*Partner – Singleton, Burroughs, and Young
Law Firm*

Dr. Robert J. Farrar, Jr., DMD
Family and Cosmetic Dentistry

Mrs. Fran B. Gilbert
Assoc. VP for Development CCU

George M. Hearn, Jr.
*Partner – Hearn, Brittan and Martin Law
Firm*

Christopher S. Huggins, CPA
*Smith, Sapp, Bookhout, Crumpler and
Callihan, P.A.*

Dr. Ronald Ingle
President – Coastal Carolina University

James J. Johnson
Retired

South Strand

A. Carroll Atkisson
President – Affordable Suites of America, Inc.

Gary F. Fette
*President – Fette Realty, LLC and Socastee
Management, LLC*

William B. Wilhelm
Broker Associate – Surfside Realty Company, Inc.

CAROLINA FINANCIAL CORPORATION

CRESCENT MORTGAGE COMPANY

OFFICERS

Michael P. Leddy
President and Chief Executive Officer

Patricia J. Anthony
Vice President
Credit/Risk Manager

John S. Kaminer
Vice President
Secondary Marketing

Fowler C. Williams
Executive Vice President
National Sales Manager

Jerry L. Rexroad
Chairman

Parthiv J. Dave
Vice President
Secondary Marketing

Michael A. Perkins
Vice President
Underwriting Manager

Kelly A. Byers
Chief Financial Officer

William F. Fowler
Vice President
Operations Manager

Jemille Y. Robinson
Senior Vice President
Quality Control and Post Closing
Manager

BOARD OF DIRECTORS

Frank J. Cole, Jr.
Executive Vice President, Secretary and Chief Financial Officer
Carolina Financial Corporation

Michael P. Leddy
President and Chief Executive Officer
Crescent Mortgage Company

Benedict P. Rosen
Retired
AVX Corporation

Robert C. KenKnight
Retired
Crescent Mortgage Company

Jerry L. Rexroad
Chairman
Executive Vice President
Carolina Financial Corporation

John D. Russ
President and Chief Executive Officer
Carolina Financial Corporation

CAROLINA FINANCIAL CORPORATION

CAROLINA SERVICE CORPORATION

OFFICERS

Joseph Bonacci

*Senior Vice President
Human Resources*

Frank J. Cole, Jr.

Executive Vice President

Robert W. Haile, Jr.

*Vice President
Treasurer*

Jamin M. Hujik

*Vice President
Special Assets Group*

James Potasky

*Vice President
Internal Auditor*

Sara Sowell

*Vice President
Loan Review*

Brian L. Canady

*Senior Vice President
Retail Sales Manager*

William A. Gehman III

Vice President and Controller

John Heinemann

*Vice President
Information Technology*

Sandra Lewis

*Senior Vice President
Operations*

John D. Russ

Chairman
President and Chief Executive Officer

Richard A. Tripp

*Vice President
Compliance*

BOARD OF DIRECTORS

Frank J. Cole, Jr.

*Executive Vice President, Secretary and Chief Financial Officer
Carolina Financial Corporation*

M. J. Huggins, III

*President and Assistant Secretary
Crescent Bank*

John D. Russ

Chairman
*President and Chief Executive Officer
Carolina Financial Corporation*

Harvey L. Glick

Bank Consultant

David L. Morrow

*Chief Executive Officer
Community FirstBank and Crescent Bank*

Donald B. Shackelford

Bank Consultant

CAROLINA FINANCIAL CORPORATION

CORPORATE INFORMATION

STOCK TRANSFER AGENT

Registrar and Transfer Company
10 Commerce Drive
Cranford, N.J. 07016
800-866-1340

SPECIAL COUNSEL

Luse Gorman Pomerenk & Schick
5335 Wisconsin Avenue, N.W., Suite 780
Washington, D.C. 20015

INDEPENDENT AUDITORS

Elliott Davis, LLC
1901 Main Street, Suite 1650
P. O. Box 2227
Columbia, SC 29202-2227

DISCLAIMER

This annual report has not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.