CapStone Bank

July 11, 2012

Dear Shareholder:

We are pleased to report very positive operating results for CapStone Bank for the quarter and six months ended June 30, 2012. We ended the second quarter with total assets of $237.7 million compared to $202.4 million on June 30, 2011, an increase of $35.3 million or 17.5%. Loans outstanding at the same time in 2012 were $163.4 million compared to $135.5 million on June 30, 2011, an increase of $27.9 million or 20.6%. Deposit growth during the same period was also very good, with deposits increasing to $175 million on June 30, 2012 from $135.4 million on June 30, 2011, an increase of $39.6 million or 29.3%. For the first six months of 2012, total assets increased $21.1 million or 9.8%, total loans increased by $16.1 million or 10.9% and total deposits increased by $23.6 million or 15.6%.

Net income for the second quarter of 2012 was $566,110 compared to $512,082 for the same period in 2011, an increase of $54,027 or 10.6%. Net income for the first six months of 2012 was $934,860 compared to $940,187 in 2011, a decrease of $5,327 or 0.6%. During the first six months of 2012, net interest income increased by $233,895 over the same period in 2011. This increase in net interest income was offset by an increase in the provision for loan losses of $389,000 or 188.8% during the same period. For the first six months of 2012, return on average assets was 0.83% and return on average equity was 6.54%. For the three months ended June 30, 2012, return on average assets was 0.99% and return on average equity was 7.89%.

During the second quarter, we experienced significant improvement in our nonperforming assets. These assets, including nonaccrual loans plus other real estate owned, declined from $7.9 million on March 31, 2012 to $4.8 million on June 30, 2012, a decrease of $3.1 million or 39%. As a percentage of total assets, they declined from 3.5% on March 31, 2012 to 2.0% on June 30, 2012. Our allowance for loan losses to total loans was 2.44% on June 30, 2012 versus 2.38% on June 30, 2011. We believe we will continue to show improvement in nonperforming assets during the remainder of 2012.

The strong growth we have experienced in both loans and deposits over the past twelve months is encouraging, especially during a period when most community banks in North Carolina have reported single digit or no growth at all. This growth, combined with our strong core earnings and improving asset quality, makes us optimistic about CapStone's financial outlook for the remainder of 2012.

During the fourth quarter of this year, we have plans to open a full-service branch in the Regency Park area of Cary, NC. After operating a loan production office in this market since March 2010, we have established a strong foundation of loan and deposit relationships which now justifies opening a full-service branch in this vibrant, high-growth community. With a great team of experienced bankers in Cary, we are excited about our future and expanding our presence there.

On behalf of our directors and management, we appreciate your support and encourage you to partner with us for your financial needs and, to refer others to YOUR bank. Please feel free to call me with any thoughts or questions you have about CapStone.

Sincerely,

Michael S. Patterson
Chairman, President and CEO

CapStone Bank

Balance Sheet

(Unaudited)

	Actual Jun 2012	Actual Jun 2011	$ Change	% Change
Assets				
Cash and due from banks	$ 4,021,992	$ 2,505,712	$ 1,516,280	60.5%
Fed funds sold & repos	5,428,184	3,172,106	2,256,078	71.1%
Interest bearing deposits with banks	17,059,219	20,447,217	(3,387,997)	-16.6%
Investment Securities - Taxable	31,422,133	26,460,317	4,961,816	18.8%
Investment Securities - Tax-exempt	13,413,678	10,900,194	2,513,484	23.1%
Loans, net of unearned income	163,428,988	135,536,887	27,892,101	20.6%
Less: Allowance for loan losses	(3,981,350)	(3,222,718)	(758,632)	23.5%
Premises and equipment, net	148,365	261,895	(113,530)	-43.3%
Accrued interest receivable	698,386	682,005	16,382	2.4%
Other assets	6,107,165	5,658,696	448,469	7.9%
Total Assets	**$ 237,746,762**	**$ 202,402,311**	**$ 35,344,451**	17.5%
Liabilities				
Non-Interest Bearing Deposits	$ 24,006,556	$ 18,843,978	$ 5,162,578	27.4%
Interest bearing demand deposits	27,407,395	24,027,635	3,379,760	14.1%
Savings and Money Market Deposits	61,399,450	36,784,257	24,615,193	66.9%
Time Deposits - Retail	25,483,578	28,287,396	(2,803,818)	-9.9%
Time Deposits - Wholesale	36,718,831	27,446,104	9,272,727	33.8%
Total Deposits	175,015,809	135,389,370	39,626,439	29.3%
Accrued expenses and other liabilities	1,990,029	1,146,025	844,005	73.6%
FHLB Advances	31,500,000	35,000,000	(3,500,000)	-10.0%
Other Borrowings	181,177	3,030,534	(2,849,358)	-94.0%
Total Liabilities	**208,687,015**	**174,565,929**	**34,121,086**	19.5%
Equity				
Common stock	12,974,365	10,812,000	2,162,365	20.0%
Capital surplus	11,634,823	13,748,179	(2,113,356)	-15.4%
Retained earnings	2,210,358	1,534,382	675,975	44.1%
Accumulated other comprehensive income (los	1,305,342	801,634	503,708	62.8%
Net Income	934,860	940,187	(5,327)	-0.6%
Total Equity	**29,059,747**	**27,836,382**	**1,223,365**	4.4%
Total Liabilities & Equity	**$ 237,746,762**	**$ 202,402,311**	**$ 35,344,451**	17.5%

CapStone Bank

Income Statement

(Unaudited)

	YTD Actual Jun 2012	YTD Actual Jun 2011	$ Change	% Change
Interest Income				
Interest on Loans	$ 3,807,587	$ 3,817,976	$ (10,389)	-0.3%
Fees on Loans	161,681	103,778	57,903	55.8%
Interest on federal funds sold	1,888	3,906	(2,017)	-51.6%
Interest on deposits with banks	171,802	227,456	(55,654)	-24.5%
Investment Securities - Taxable	502,449	418,413	84,036	20.1%
Investment Securities - Tax-exempt	241,761	182,879	58,882	32.2%
Total Interest Income	4,887,169	4,754,408	132,761	2.8%
Interest Expense				
Interest bearing demand deposits	53,825	73,979	(20,154)	-27.2%
Savings and Money Market Deposits	166,950	142,651	24,299	17.0%
Time Deposits - Retail	131,179	209,328	(78,149)	-37.3%
Time Deposits - Wholesale	109,508	105,046	4,462	4.2%
Total Interest Expense on Deposits	461,462	531,004	(69,542)	-13.1%
FHLB Advances	264,192	296,567	(32,375)	-10.9%
Interest on other borrowings	2,626	1,843	783	42.5%
Total Interest Expense	728,280	829,413	(101,133)	-12.2%
Net Interest Income	**4,158,890**	**3,924,995**	**233,895**	6.0%
Provision for loan losses	595,000	206,000	389,000	188.8%
Net In. Inc. After Prov. for Loan Losses	**3,563,890**	**3,718,995**	**(155,105)**	-4.2%
Non Interest Income				
Service charges and fees	49,694	37,306	12,388	33.2%
Securities gains (losses), net	131,792	2,603	129,188	4963.0%
Mortgage loan and related fees	20,342	11,242	9,099	80.9%
Other noninterest income	53,080	63,873	(10,793)	-16.9%
Total Non Interest Income	254,907	115,025	139,882	121.6%
Non Interest Expense				
Salaries and employee benefits	1,486,102	1,499,012	(12,910)	-0.9%
Occupancy	169,463	208,474	(39,011)	-18.7%
Other noninterest expense	785,372	679,347	106,025	15.6%
Total Non Interest Expense	2,440,937	2,386,833	54,104	2.3%
Income Before Taxes	**1,377,860**	**1,447,187**	**(69,327)**	-4.8%
Income taxes	443,000	507,000	(64,000)	-12.6%
Net Income	**$ 934,860**	**$ 940,187**	**$ (5,327)**	-0.6%