GBTS 10-K 12/31/2007

Section 1: 10-K (GATEWAY FINANCIAL HOLDINGS, INC.)

U. S. Securities and Exchange Commission
Washington, D.C. 20549

Form 10-K

☑ **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the fiscal year ended December 31, 2007

☐ **Transition Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period from _________ to _________

Commission file number 000-33223

Gateway Financial Holdings, Inc.

(Exact name of registrant as specified in its charter)

North Carolina	**56-2040581**
(State of incorporation)	(IRS Employer Identification No.)
1580 Laskin Road, Virginia Beach, Virginia	**23451**
(Address of principal executive offices)	(Zip code)

(757) 422-4055
(Registrant's telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Exchange Act:

Title of each class	Exchange on which registered
Common Stock, No Par Value	The NASDAQ Stock Market, LLC

Securities registered under Section 12(g) of the Act: None.

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☑

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☑

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☑ No ☐

Indicate by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act).

large accelerated filer ☐ accelerated filer ☑ non-accelerated filer ☐ smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined Rule 12b-2 of the Act). Yes ☐ No ☑

State issuer's revenues for its most recent fiscal year $127.3 million.

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter: $160.7 million.

As of March 10, 2008, (the most recent practicable date), the registrant had outstanding 12,650,985 shares of common stock, no par value per share.

Documents Incorporated By Reference

Document	Where Incorporated
1. Proxy Statement for the Annual Meeting of Shareholders to be held May 19, 2008 to be mailed to shareholders within 120 days of December 31, 2007.	Part III

Form 10-K Table of Contents

Index	PAGE
PART I	
Item 1. Description of Business	3
Item 1A. Risk Factors	11
Item 1B. Unresolved Staff Comments	17
Item 2. Properties	17
Item 3. Legal Proceedings	18
Item 4. Submission of Matters to a Vote of Security Holders	18
PART II	
Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	18
Item 6. Selected Financial Data	20
Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations	21
Item 7A. Quantitative and Qualitative Disclosures About Market Risk	21
Item 8. Financial Statements and Supplementary Data	49
Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	92
Item 9A. Controls and Procedures	92
Item 9B. Other Information	95
PART III	
Item 10. Directors, Executive Officers, and Corporate Governance	95
Item 11. Executive Compensation	95
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	95
Item 13. Certain Relationships and Related Transactions, and Director Independence	96
Item 14. Principal Accounting Fees and Services	96
PART IV	
Item 15. Exhibits, Financial Statement Schedules	96
Exhibit 3.1	
Exhibit 3.2	
Exhibit 3.3	
Exhibit 10.4	
Exhibit 10.5	
Exhibit 10.7	
Exhibit 10.8	
Exhibit 10.9	
Exhibit 10.10	
Exhibit 21	
Exhibit 23	
Exhibit 31.1	
Exhibit 31.2	
Exhibit 32	

PART I

ITEM 1. – DESCRIPTION OF BUSINESS

General

Gateway Financial Holdings, Inc. is a financial holding company incorporated under the laws of North Carolina to serve as the holding company for Gateway Bank & Trust Co., a North Carolina chartered commercial bank with banking and insurance agency offices in eastern North Carolina and eastern Virginia. The bank began operations on December 1, 1998, and, effective October 1, 2001, became our wholly owned subsidiary.

Since inception, we have aggressively pursued the primary objective of building a full-service commercial banking operation, while effectively supplementing our banking activities with other financial services intended to generate significant non-interest income. Accordingly, a key component of our growth strategy has been expanding our franchise through the opening of newly constructed financial centers and strategic financial center acquisitions. We have grown into a regional community bank with a total of thirty-three full-service financial centers — nineteen in Virginia: Virginia Beach (7), Richmond (6), Chesapeake (3), Suffolk, Norfolk and Emporia; and fourteen in North Carolina: Elizabeth City (3), Edenton, Kitty Hawk (2), Raleigh (3), Moyock, Nags Head, Plymouth, Roper, and Wilmington. We acquired The Bank of Richmond, N.A., effective June 1, 2007, and operate the six financial centers in the Richmond metropolitan area and one loan production office in Charlottesville, Virginia, under the assumed name "The Bank of Richmond." Consistent with our long-range strategic objectives, we will continue to consider acquisition opportunities including whole bank or financial center locations. We will also continue to explore de novo financial center opportunities in markets that we consider attractive. We currently intend to open five additional new financial centers in 2008, including our first financial centers in Chapel Hill and Wake Forest, North Carolina, and Charlottesville and Lynchburg, Virginia, as well as our second office in Emporia, Virginia

The bank has four wholly-owned operating subsidiaries. Gateway Insurance Services, Inc., an insurance agency with offices in Edenton, Hertford, Elizabeth City, Plymouth, Moyock and Kitty Hawk, North Carolina, and the Hampton Roads area of Virginia, sells insurance products to businesses and individuals. Gateway Investment Services, Inc., assists Bank customers in their securities brokerage activities through an arrangement with an unaffiliated broker-dealer. As prescribed by this arrangement, Gateway Investment Services earns revenue through a commission sharing arrangement with the unaffiliated broker-dealer. Gateway Bank Mortgage, Inc., provides mortgage banking services with products that are sold on the secondary market. Gateway Title Agency, Inc., engages in title insurance and settlement services for real estate transactions. In an ongoing effort to create significant sources of non-interest income, we will continue to look for ways to expand non-traditional banking activities in our insurance and investment services subsidiaries.

Since inception, we have concentrated our efforts on building a franchise and infrastructure that can deliver and sustain long-term profitability. We have been profitable for twenty-four consecutive quarters, producing net income of $3.9 million in 2005, $5.3 million in 2006, and $11.0 million during the year ended December 31, 2007. While we anticipate continued profitability, future expansion activity can be expected to generate significant additional costs that can negatively impact earnings as we pursue our growth strategies.

Market Area and Growth Strategy

Our current market area consists of the following five geographic regions: (1) the Richmond, Virginia metropolitan statistical area; (2) the Greater Metropolitan Hampton Roads area of Virginia; (3) the Northeastern coastal region of North Carolina (geographically contiguous to Hampton Roads), including the Outer Banks; (4) the Research Triangle area of North Carolina (includes Raleigh); and, most recently, (5) the Southeastern coastal region of North Carolina (includes Wilmington). The Hampton Roads area, which includes the cities of Norfolk, Virginia Beach, Suffolk and Chesapeake, is the second largest urban concentration in the southern United States with a 2006 population, estimated by the U.S. Census Bureau, of over 1.67 million. Additionally, Virginia Beach is the largest city, as measured by population, in the Commonwealth of Virginia. The Northeastern coastal region of North Carolina is a bedroom community for the Hampton Roads area and the Outer Banks includes such prime vacation areas as Corolla, Duck, Kitty Hawk, Kill Devil Hills, Manteo, Nags Head, and Southern Shores. According to the Environmental Systems Research Institute ("ESRI"), a leading national demographic forecaster, the projected population growth from 2005 to 2010 in the Hampton Roads and Northeastern North Carolina banking markets is 7.8% compared to 6.3% for the entire United States.

The Raleigh-Cary Metropolitan area is the 51st largest metropolitan area in the United States with a 2006 population,

estimated by the U.S. Census Bureau, of almost 994 thousand. According to ESRI, the MSA of Raleigh has a projected population growth of 15.8% from 2005 to 2010. Richmond, Virginia is the 45th largest metropolitan area in the United States with a 2006 population, estimated by the U.S. Census Bureau, of over 1.13 million.

We emphasize personalized service, access to decision makers, and a quick turn around time on lending decisions. Our slogan is "Real People . . . Real Solutions." We have a management team with extensive experience in our local markets. We intend to leverage the core relationships we build by providing a variety of services to our customers. With that focus, we target:

- Small-and medium-sized businesses;
- Professionals and middle managers of locally based companies;
- Residential real estate developers; and
- Individual consumers.

We believe that these segments are the most under-served by local financial centers of national and super-regional financial institutions. We also intend to continue to diversify our revenue in order to continue to generate significant non-interest income. We presently offer investment brokerage and insurance services, and we originate mortgage loans for sale in the secondary market.

We believe that economic growth and bank consolidation have created a growing number of businesses and consumers in need of high quality banking and other financial services delivered with personalized attention. Consolidation in the banking market has dislocated experienced and talented management and lending personnel. As a result, we believe we have a substantial opportunity to attract experienced management, loan officers and banking customers both within our current markets and other markets in which we might expand in Virginia and North Carolina. Our business plan is to capitalize on this opportunity by developing a financial center network in growing areas within Virginia and North Carolina where we can hire experienced bankers with a loyal following of deposit and loan customers. Our plan has been to start new financial centers after we have identified either an experienced banker who will have responsibility for that market or an existing office in a location with favorable growth characteristics that is being sold by another bank. We believe that it takes a combination of an attractive location and experienced, talented people to be successful in expanding our franchise. We intend to build upon existing relationships and create new relationships and new markets by de novo expansion, further financial center acquisitions, or potential whole bank acquisitions which make strategic and economic sense.

We intend to achieve our primary goal of maximizing long-term returns to stockholders by focusing on the following objectives:

- *Emphasize relationship banking.* We have been successful in building client relationships because our regional model enables us to deliver products and services that are comparable to that of our largest competitors and high customer service levels that are most commonly associated with community banks. The Bank has divided its markets into six regions. Each region has its own Market President whose knowledge of his region, presence in his community and ability to make prompt credit decisions, strengthens our ability to develop local relationships. We typically render commercial loan decisions within 48 hours and retail loans within an hour. Localized decision making and personalized customer service form the core of our relationship banking strategy, and we plan to maintain this approach as we continue to grow in both our existing markets and new markets.
- *Grow organically in our existing markets.* Our markets have been subject to significant bank consolidation. We believe there is a large customer base in our markets that prefers doing business with a local institution and may be dissatisfied with the service received from national and super-regional banks. By providing our customers with personalized service and a big bank product suite, we expect to continue our strong growth.
- *Expand franchise in high growth markets.* We will actively consider both acquisitions and de novo financial center opportunities in existing and new market areas. During 2007, we have acquired The Bank of Richmond, N.A., and opened three new de novo financial centers (two in Raleigh, North Carolina, and our first financial center in Wilmington, North Carolina). We are focused on markets in central and eastern Virginia and central and eastern North Carolina that possess favorable growth characteristics and in which we have identified experienced bankers to help execute our strategy. For example, we intend to open our next financial centers in Chapel Hill and Wake Forest, North Carolina, and Charlottesville and Lynchburg, Virginia.
- *Grow insurance agency through acquisitions.* Our independent insurance agency was created through the acquisition and integration of three independent insurance agencies. During 2007, we successfully

integrated the acquisitions of two insurance agencies we acquired in the fourth quarter of 2006, and acquired, as a separate subsidiary, a mortgage insurance and real estate settlement agency in the Greater Hampton Roads area of Virginia. We will actively consider acquisitions in both our existing market areas and in other growing markets in eastern and central Virginia and eastern and central North Carolina that have favorable market demographics for our insurance agency subsidiary.

- *Grow non-interest income through mortgage subsidiary.* We operate our own mortgage subsidiary. We intend to actively seek mortgage originations in both our existing market areas and in other growing markets in eastern and central Virginia and eastern and central North Carolina.
- *Improve our core profitability.* We believe as we grow our franchise that we will be able to take advantage of the economies of scale typically enjoyed by larger organizations. We believe the investments we have made in the expansion of our financial center network and technology infrastructure are sufficient to support a much larger organization, and therefore believe increases in our expense base going forward should be lower than our proportional increase in assets and revenues.
- *Continue our disciplined execution.* We believe our success as a banking organization depends on a disciplined approach to originating loans and monitoring the performance of our loan portfolio. Despite our growth, we have consistently maintained strong asset quality. We believe our strong asset quality is the result of conservative underwriting standards, experienced loan officers and the strength of the local economies in which we operate.

Competition

Our subsidiary bank faces considerable competition in its market areas for deposits and loans from other depository institutions. Many of the bank's depository institution competitors have substantially greater resources, broader geographic markets, and higher lending limits than the bank and are also able to provide more services and make greater use of media advertising. In recent years, intense market demands, economic pressures, and increased customer awareness of products and services, and the availability of electronic services have forced banks to diversify their services and become more cost-effective. Also, with the elimination of restrictions on interstate banking, our bank may be required to compete with out-of-state financial institutions that are not presently in its market area. Our bank presently faces strong competition in attracting and retaining deposits and loans. Based upon FDIC data as of June 30, 2007, in the Greater Hampton Roads Metropolitan Statistical Area, there were 376 financial centers operated by 32 banking institutions with approximately $18.4 billion in deposits. Our bank's total deposits were approximately $496.3 million in the Hampton Roads market and $641.2 in the adjacent Northeastern North Carolina markets on that date. Based upon FDIC data as of June 30, 2007, in the Raleigh-Cary Metropolitan Statistical Area, there were 276 financial centers operated by 32 banking institutions with approximately $15.6 billion in deposits. The bank had almost $75.7 million in deposits in Raleigh on that date. On that date, FDIC data indicated that the Richmond area market had 374 financial centers operated by 38 banking institutions with over $34.8 billion in deposits and the bank had almost $208.4 million in deposits in the Richmond area on that date.

The bank also competes with credit unions, brokerage firms, insurance companies, money market mutual funds, consumer finance companies, mortgage companies and other financial companies, some of which are not subject to the same degree of regulation and restrictions as the bank in attracting deposits and making loans. Interest rates on deposit accounts, convenience of facilities, products and services, and marketing are all significant factors in the competition for deposits. Competition for loans comes from other commercial banks, savings institutions, insurance companies, consumer finance companies, credit unions, mortgage banking firms and other institutional lenders. We primarily compete for loan originations through our handling of loans and the overall quality of service. Competition is affected by the availability of lendable funds, general and local economic conditions, interest rates, and other factors that are not readily predictable.

We expect competition will continue in the future due to statewide financial center laws and the entry of additional bank and nonbank competitors in our markets.

Other Products and Services

Other Banking Products and Services.

To enable our bank to offer more personalized service to its customers, we offer a range of products and services, including 24-hour internet banking, direct deposit, travelers' checks, safe deposit boxes, United States savings bonds and automatic account transfers. We earn fees for most of these services. We also receive ATM transaction fees

from transactions performed by our customers participating in a shared network of automated teller machines and a debit card system that our customers can use throughout our market areas and in other states.

Other Financial Services.

Through its subsidiary, Gateway Investment Services, Inc., our bank uses a networking arrangement to make available securities brokerage products to its customers. We also offer property, casualty, life and health insurance products to businesses and individuals through our bank's insurance subsidiary, Gateway Insurance Services, Inc. Gateway Insurance Services is an independent insurance agency that does not engage in insurance underwriting. It has offices in Edenton, Hertford, Elizabeth City, Moyock, Plymouth and Kitty Hawk, North Carolina, and Chesapeake and Newport News, Virginia. The bank's subsidiary, Gateway Title Agency, Inc., engages in title insurance and settlement services for real estate transactions and its mortgage banking subsidiary, Gateway Bank Mortgage, Inc., offers our customers a range of mortgage products that are sold on the secondary market.

Employees

The Company had 420 full-time equivalent employees at December 31, 2007. None of the Company's employees are covered by a collective bargaining agreement. The Company considers its relations with its employees to be good.

SUPERVISION AND REGULATION

Banking is a complex, highly regulated industry. The primary goals of the bank regulatory scheme are to maintain a safe and sound banking system and to facilitate the conduct of sound monetary policy. In furtherance of these goals, Congress has created several largely autonomous regulatory agencies and enacted numerous laws that govern banks, bank holding companies and the banking industry. The descriptions of and references to the statutes and regulations below are brief summaries and do not purport to be complete. The descriptions are qualified in their entirety by reference to the specific statutes and regulations discussed.

Gateway Financial Holdings, Inc.

We are a bank holding company that has elected to be treated as a financial holding company. As a bank holding company under the Bank Holding Company Act of 1956, as amended, we are registered with and subject to regulation by the Federal Reserve. We are required to file annual and other reports with, and furnish information to, the Federal Reserve. The Federal Reserve conducts periodic examinations of us and may examine any of our subsidiaries, including the bank.

The Bank Holding Company Act provides that a bank holding company must obtain the prior approval of the Federal Reserve for the acquisition of more than five percent of the voting stock or substantially all the assets of any bank or bank holding company. In addition, the Bank Holding Company Act restricts the extension of credit to any bank holding company by its subsidiary bank. The Bank Holding Company Act also provides that, with certain exceptions, a bank holding company may not engage in any activities other than those of banking or managing or controlling banks and other authorized subsidiaries or own or control more than five percent of the voting shares of any company that is not a bank. The Federal Reserve has deemed limited activities to be closely related to banking and therefore permissible for a bank holding company.

Subject to various limitations, the Gramm-Leach-Bliley Financial Services Modernization Act of 1999 permits a bank holding company to elect to become a "financial holding company." A financial holding company greatly expands the scope of activities in which a bank holding company may engage by allowing it to affiliate with securities firms and insurance companies and engage in other activities that are "financial in nature." Among the activities that are deemed "financial in nature" are, in addition to traditional lending activities, securities underwriting, dealing in or making a market in securities, sponsoring mutual funds and investment companies, insurance underwriting and agency activities, certain merchant banking activities, as well as activities that the Federal Reserve considers to be closely related to banking.

A bank holding company may become a financial holding company under the Modernization Act if each of its subsidiary banks is "well-capitalized" under the Federal Deposit Insurance Corporation Improvement Act prompt corrective action provisions, is well managed and has at least a satisfactory rating under the Community

Reinvestment Act. In addition, the bank holding company must file a declaration with the Federal Reserve that the bank holding company wishes to become a financial holding company. A bank holding company that falls out of compliance with these requirements may be required to cease engaging in some of its activities.

Under the Modernization Act, the Federal Reserve serves as the primary "umbrella" regulator of financial holding companies, with supervisory authority over each parent company and limited authority over its subsidiaries. Expanded financial activities of financial holding companies generally will be regulated according to the type of such financial activity: banking activities by banking regulators, securities activities by securities regulators and insurance activities by insurance regulators. The Modernization Act also imposes additional restrictions and heightened disclosure requirements regarding private information collected by financial institutions.

Enforcement Authority. We will be required to obtain the approval of the Federal Reserve prior to engaging in or, with certain exceptions, acquiring control of more than 5% of the voting shares of a company engaged in, any new activity. Prior to granting such approval, the Federal Reserve must weigh the expected benefits of any such new activity to the public (such as greater convenience, increased competition, or gains in efficiency) against the risk of
possible adverse effects of such activity (such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices). The Federal Reserve has cease-and-desist powers over bank holding companies and their nonbanking subsidiaries where their actions would constitute a serious threat to the safety, soundness or stability of a subsidiary bank. The Federal Reserve also has authority to regulate debt obligations (other than commercial paper) issued by bank holding companies. This authority includes the power to impose interest ceilings and reserve requirements on such debt obligations. A bank holding company and its subsidiaries are also prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, lease or sale of property or furnishing of services.

Interstate Acquisitions. Federal banking law generally provides that a bank holding company may acquire or establish banks in any state of the United States, subject to certain aging and deposit concentration limits. In addition, North Carolina banking laws permit a bank holding company which owns stock of a bank located outside North Carolina to acquire a bank or bank holding company located in North Carolina. Federal banking law will not permit a bank holding company to own or control banks in North Carolina if the acquisition would exceed 20% of the total deposits of all federally-insured deposits in North Carolina.

Capital Adequacy. The Federal Reserve has promulgated capital adequacy regulations for all bank holding companies with assets in excess of $150 million. The Federal Reserve’s capital adequacy regulations are based upon a risk-based capital determination, whereby a bank holding company’s capital adequacy is determined in light of the risk, both on- and off-balance sheet, contained in the company’s assets. Different categories of assets are assigned risk weightings and are counted at a percentage of their book value.

The regulations divide capital between Tier 1 capital (core capital) and Tier 2 capital. For a bank holding company, Tier 1 capital consists primarily of common stock, related surplus, noncumulative perpetual preferred stock, minority interests in consolidated subsidiaries and a limited amount of qualifying cumulative preferred securities. Goodwill and certain other intangibles are excluded from Tier 1 capital. Tier 2 capital consists of an amount equal to the allowance for loan and lease losses up to a maximum of 1.25% of risk-weighted assets, limited other types of preferred stock not included in Tier 1 capital, hybrid capital instruments and term subordinated debt. Investments in and loans to unconsolidated banking and finance subsidiaries that constitute capital of those subsidiaries are excluded from capital. The sum of Tier 1 and Tier 2 capital constitutes qualifying total capital. The Tier 1 component must comprise at least 50% of qualifying total capital.

Every bank holding company has to achieve and maintain a minimum Tier 1 capital ratio of at least 4.0% and a minimum total capital ratio of at least 8.0%. In addition, banks and bank holding companies are required to maintain a minimum leverage ratio of Tier 1 capital to average total consolidated assets (leverage capital ratio) of at least 3.0% for the most highly-rated, financially sound banks and bank holding companies and a minimum leverage ratio of at least 4.0% for all other banks. The Federal Deposit Insurance Corporation and the Federal Reserve define Tier 1 capital for banks in the same manner for both the leverage ratio and the risk-based capital ratio. However, the Federal Reserve defines Tier 1 capital for bank holding companies in a slightly different manner. As of December 31, 2007, our Tier 1 leverage capital ratio and total capital were 9.76% and 11.40%, respectively.

The guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory level, without significant reliance on intangible assets. The guidelines also indicate that the Federal Reserve will continue to consider a "Tangible Tier 1 Leverage Ratio" in evaluating proposals for expansion or new activities. The Tangible Tier 1

Leverage Ratio is the ratio of Tier 1 capital, less intangibles not deducted from Tier 1 capital, to quarterly average total assets. As of December 31, 2007, the Federal Reserve had not advised us of any specific minimum Tangible Tier 1 Leverage Ratio applicable to us.

Source of Strength for Subsidiary. Bank holding companies are required to serve as a source of financial strength for their depository institution subsidiaries, and, if their depository institution subsidiaries become undercapitalized, bank holding companies may be required to guarantee the subsidiaries' compliance with capital restoration plans filed with their bank regulators, subject to certain limits.

Dividends. As a holding company that does not, as an entity, currently engage in separate business activities of a material nature, our ability to pay cash dividends depends upon the cash dividends received from our subsidiary bank and management fees paid by the bank. We must pay our operating expenses from funds we receive from the bank. Therefore, shareholders may receive cash dividends from us only to the extent that funds are available after payment of operating expenses. In addition, the Federal Reserve generally prohibits bank holding companies from paying cash dividends except out of operating earnings, provided that the prospective rate of earnings retention appears consistent with the bank holding company's capital needs, asset quality and overall financial condition. As a North Carolina corporation, our payment of cash dividends is subject to the restrictions under North Carolina law on the declaration of cash dividends. Under such provisions, cash dividends may not be paid if a corporation will not be able to pay its debts as they become due in the usual course of business after paying such a cash dividend or if the corporation's total assets would be less than the sum of its total liabilities plus the amount that would be needed to satisfy certain liquidation preferential rights.

Change of Control. State and federal banking law restricts the amount of voting stock of a bank that a person may acquire without the prior approval of banking regulators. The Bank Holding Company Act requires that a bank holding company obtain the approval of the Federal Reserve before it may merge with a bank holding company, acquire a subsidiary bank, acquire substantially all of the assets of any bank, or before it may acquire ownership or control of any voting shares of any bank or bank holding company if, after such acquisition, it would own or control, directly or indirectly, more than 5% of the voting shares of that bank or bank holding company. The overall effect of such laws is to make it more difficult to acquire our company by tender offer or similar means than it might be to acquire control of another type of corporation. Consequently, our shareholders may be less likely to benefit from rapid increases in stock prices that often result from tender offers or similar efforts to acquire control of other types of companies.

Gateway Bank & Trust Co.

The bank is subject to various requirements and restrictions under the laws of the United States and the State of North Carolina. As a North Carolina bank, the bank is subject to regulation, supervision and regular examination by the North Carolina Banking Commission. As a member of the Federal Reserve, the bank is subject to regulation, supervision and regular examination by the Federal Reserve. The North Carolina Banking Commission and the Federal Reserve have the power to enforce compliance with applicable banking statutes and regulations. These requirements and restrictions include requirements to maintain reserves against deposits, restrictions on the nature and amount of loans that may be made and the interest that may be charged thereon and restrictions relating to investments and other activities of the bank.

Transactions with Affiliates. The bank may not engage in specified transactions (including, for example, loans) with its affiliates unless the terms and conditions of those transactions are substantially the same or at least as favorable to the Bank as those prevailing at the time for comparable transactions with or involving other nonaffiliated entities. In the absence of comparable transactions, any transaction between the bank and its affiliates must be on terms and under circumstances, including credit standards, which in good faith would be offered or would apply to nonaffiliated companies. In addition, transactions referred to as "covered transactions" between the Bank and its affiliates may not exceed 10% of the bank's capital and surplus per affiliate and an aggregate of 20% of its capital and surplus for covered transactions with all affiliates. Certain transactions with affiliates, such as loans, also must be secured by collateral of specific types and amounts. The bank also is prohibited from purchasing low-quality assets from an affiliate. Every company under common control with the bank, including our company, is deemed to be an affiliate of the bank.

Loans to Insiders. Federal law also constrains the types and amounts of loans that the bank may make to its executive officers, directors and principal shareholders. Among other things, these loans are limited in amount, must be approved by the bank's board of directors in advance, and must be on terms and conditions as favorable to the bank as those available to an unrelated person.

Regulation of Lending Activities. Loans made by the bank are also subject to numerous federal and state laws and regulations, including the Truth-In-Lending Act, Federal Consumer Credit Protection Act, the Equal Credit Opportunity Act, the Real Estate Settlement Procedures Act and adjustable rate mortgage disclosure requirements. Remedies to the borrower or consumer and penalties to the bank are provided if the bank fails to comply with these laws and regulations. The scope and requirements of these laws and regulations have expanded significantly in recent years.

Financial Centers. All banks located in North Carolina are authorized to financial center statewide. Accordingly, a bank located anywhere in North Carolina has the ability, subject to regulatory approval, to establish financial center facilities near any of our facilities and within our market area. If other banks were to establish financial center facilities near our facilities, it is uncertain whether these financial center facilities would have a material adverse effect on our business.

Federal law provides for nationwide interstate banking, and subject to certain aging and deposit concentration limits that may be imposed under applicable state laws. Applicable North Carolina statutes permit regulatory authorities to approve de novo financial center in North Carolina by institutions located in states that would permit North Carolina institutions to financial center on a de novo basis into those states. Federal regulations prohibit an out-of-state bank from using interstate financial center authority primarily for the purpose of deposit production. These regulations include guidelines to insure that interstate financial centers operated by an out-of-state bank in a host state are reasonably helping to meet the credit needs of the host state communities served by the out-of-state bank.

Pursuant to a regulatory agreement between the state banking regulatory authorities in North Carolina and Virginia, we are permitted to open and operate financial centers in Virginia. The Virginia banking regulator has the opportunity to comment on our operations in Virginia, but the bank's Virginia operations are subject to regulation, supervision and regular examination by the North Carolina Commissioner of Banks.

Reserve Requirements. Pursuant to regulations of the Federal Reserve, the bank must maintain average daily reserves against its transaction accounts. During 2007, no reserves were required to be maintained on the first $8.5 million of transaction accounts, but reserves equal to 3.0% were required on the aggregate balances of those accounts between $8.5 million and $45.8 million, and additional reserves were required on aggregate balances in excess of $45.8 million in an amount equal to 10.0% of the excess. These percentages are subject to annual adjustment by the Federal Reserve, which has advised that for 2008, no reserves will be required to be maintained on the first $9.3 million of transaction accounts, but reserves equal to 3.0% will be required on the aggregate balances of those accounts between $9.3 million and $43.9 million, and additional reserves are required on aggregate balances in excess of $43.9 million in an amount equal to 10.0% of the excess. Because required reserves must be maintained in the form of vault cash or in a non-interest-bearing account at a Federal Reserve Bank, the effect of the reserve requirement is to reduce the amount of the institution's interest-earning assets. As of December 31, 2007, the bank met its reserve requirements.

Community Reinvestment. Under the Community Reinvestment Act ("CRA"), as implemented by regulations of the federal bank regulatory agencies, an insured bank has a continuing and affirmative obligation, consistent with its safe and sound operation, to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for banks, nor does it limit a bank's discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. The CRA requires the federal bank regulatory agencies, in connection with their examination of insured banks, to assess the banks' records of meeting the credit needs of their communities, using the ratings of "outstanding," "satisfactory," "needs to improve," or "substantial noncompliance," and to take that record into account in its evaluation of certain applications by those banks. All banks are required to make public disclosure of their CRA performance ratings. The bank received a "satisfactory" rating in its most recent CRA examination.

Governmental Monetary Policies. The commercial banking business is affected not only by general economic conditions but also by the monetary policies of the Federal Reserve. Changes in the discount rate on member bank borrowings, control of borrowings, open market transactions in United States government securities, the imposition of and changes in reserve requirements against member banks and deposits and assets of foreign financial centers, and the imposition of and changes in reserve requirements against certain borrowings by banks and their affiliates are some of the monetary policies available to the Federal Reserve. Those monetary policies influence to a significant extent the overall growth of all bank loans, investments and deposits and the interest rates charged on loans or paid on time and savings deposits in order to mitigate recessionary and inflationary pressures. These

techniques are used in varying combinations to influence overall growth and distribution of bank loans, investments, and deposits, and their use may also affect interest rates charged on loans or paid for deposits.

The monetary policies of the Federal Reserve Board have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. In view of changing conditions in the national economy and money markets, as well as the effect of actions by monetary and fiscal authorities, no prediction can be made as to possible future changes in interest rates, deposit levels, loan demand or the business and earnings of the bank.

Dividends. All dividends paid by the bank are paid to our company, the sole shareholder of the bank. The general dividend policy of the bank is to pay dividends at levels consistent with maintaining liquidity and preserving applicable capital ratios and servicing obligations. The payment of dividends is subject to the discretion of the board of directors of the bank and will depend upon such factors as future earnings, financial condition, cash needs, capital adequacy, compliance with applicable statutory and regulatory requirements and general business conditions.

The ability of the bank to pay dividends is restricted under applicable law and regulations. Under North Carolina banking law, dividends must be paid out of retained earnings and no cash dividends may be paid if payment of the dividend would cause the bank’s surplus to be less than 50% of its paid-in capital. Also, under federal banking law, no cash dividend may be paid if the bank is undercapitalized or insolvent or if payment of the cash dividend would render the bank undercapitalized or insolvent, and no cash dividend may be paid by the bank if it is in default of any deposit insurance assessment due to the Federal Deposit Insurance Corporation.

The exact amount of future dividends on the stock of the bank will be a function of the profitability of the bank in general and applicable tax rates in effect from year to year. The bank’s ability to pay dividends in the future will directly depend on its future profitability, which cannot be accurately estimated or assured.

Capital Adequacy. The capital adequacy regulations which apply to state banks, such as the bank, are similar to the Federal Reserve requirements promulgated with respect to bank holding companies discussed above.

Changes in Management. Any depository institution that has been chartered less than two years, is not in compliance with the minimum capital requirements of its primary federal banking regulator, or is otherwise in a troubled condition must notify its primary federal banking regulator of the proposed addition of any person to the board of directors or the employment of any person as a senior executive officer of the institution at least 30 days before such addition or employment becomes effective. During this 30-day period, the applicable federal banking regulatory agency may disapprove of the addition of such director or employment of such officer. The bank is not subject to any such requirements.

Enforcement Authority. The federal banking laws also contain civil and criminal penalties available for use by the appropriate regulatory agency against certain "institution-affiliated parties" primarily including management, employees and agents of a financial institution, as well as independent contractors such as attorneys and accountants and others who participate in the conduct of the financial institution’s affairs and who caused or are likely to cause more than minimum financial loss to or a significant adverse affect on the institution, who knowingly or recklessly violate a law or regulation, breach a fiduciary duty or engage in unsafe or unsound practices. These practices can include the failure of an institution to timely file required reports or the submission of inaccurate reports. These laws authorize the appropriate banking agency to issue cease and desist orders that may, among other things, require affirmative action to correct any harm resulting from a violation or practice, including restitution, reimbursement, indemnification or guarantees against loss. A financial institution may also be ordered to restrict its growth, dispose of certain assets or take other action as determined by the primary federal banking agency to be appropriate.

Prompt Corrective Action. Banks are subject to restrictions on their activities depending on their level of capital. Federal "prompt corrective action" regulations divide banks into five different categories, depending on their level of capital. Under these regulations, a bank is deemed to be "well-capitalized" if it has a total risk-based capital ratio of 10% or more, a core capital ratio of six percent or more and a leverage ratio of five percent or more, and if the bank is not subject to an order or capital directive to meet and maintain a certain capital level. Under these regulations, a bank is deemed to be "adequately capitalized" if it has a total risk-based capital ratio of eight percent or more, a core capital ratio of four percent or more and a leverage ratio of four percent or more (unless it receives the highest composite rating at its most recent examination and is not experiencing or anticipating significant growth, in which instance it must maintain a leverage ratio of three percent or more). Under these regulations, a bank is deemed to be "undercapitalized" if it has a total risk-based capital ratio of less than eight percent, a core capital ratio of less than four percent or a leverage ratio of less than three percent. Under these regulations, a bank is

deemed to be "significantly undercapitalized" if it has a risk-based capital ratio of less than six percent, a core capital ratio of less than three percent and a leverage ratio of less than three percent. Under such regulations, a bank is deemed to be "critically undercapitalized" if it has a leverage ratio of less than or equal to two percent. In addition, the applicable federal banking agency has the ability to downgrade a bank's classification (but not to "critically undercapitalized") based on other considerations even if the bank meets the capital guidelines. If a state member bank, such as the Bank, is classified as undercapitalized, the bank is required to submit a capital restoration plan to the Federal Reserve. An undercapitalized bank is prohibited from increasing its assets, engaging in a new line of business, acquiring any interest in any company or insured depository institution, or opening or acquiring a new financial center office, except under certain circumstances, including the acceptance by the Federal Reserve of a capital restoration plan for that bank.

If a state member bank is classified as undercapitalized, the Federal Reserve may take certain actions to correct the capital position of the bank. If a state member bank is classified as significantly undercapitalized, the Federal Reserve would be required to take one or more prompt corrective actions. These actions would include, among other things, requiring sales of new securities to bolster capital, changes in management, limits on interest rates paid, prohibitions on transactions with affiliates, termination of certain risky activities and restrictions on compensation paid to executive officers. If a bank is classified as critically undercapitalized, the bank must be placed into conservatorship or receivership within 90 days, unless the Federal Deposit Insurance Corporation determines otherwise.

The capital classification of a bank affects the frequency of examinations of the bank and impacts the ability of the bank to engage in certain activities and affects the deposit insurance premiums paid by the bank. The Federal Reserve is required to conduct a full-scope, on-site examination of every member bank at least once every twelve months.

Banks also may be restricted in their ability to accept brokered deposits, depending on their capital classification. "Well-capitalized" banks are permitted to accept brokered deposits, but all banks that are not well-capitalized are not permitted to accept such deposits. The Federal Reserve may, on a case-by-case basis, permit member banks that are adequately capitalized to accept brokered deposits if the Federal Reserve determines that acceptance of such deposits would not constitute an unsafe or unsound banking practice with respect to the bank.

Deposit Insurance. The bank's deposits are insured up to $100,000 per insured non-IRA account and up to $250,000 per IRA account by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation. The bank is required to pay deposit insurance assessments set by the FDIC. The FDIC determines the Bank's deposit insurance assessment rates on the basis of four risk categories. The bank's assessment will range from 0.02 to 0.04% at the lowest assessment category up to a maximum assessment of 0.40% of the bank's average deposit base, with the exact assessment determined by the bank's assets, its capital and the FDIC's supervisory opinion of its operations. The insurance assessment rate may change periodically and was significantly increased for all depository institutions during 2007. Increases in the assessment rate may have an adverse effect on the bank's operating results. The FDIC has the authority to terminate deposit insurance.

Future legislation and regulations.

Our management and the bank's management cannot predict what other legislation might be enacted or what other regulations might be adopted or the effects thereof. Any change in applicable law or regulation, state or federal, may have a material adverse effect on their business.

ITEM 1A – RISK FACTORS

An investment in our common stock involves risks. Shareholders should carefully consider the risks described below in conjunction with the other information in this Form 10K and information incorporated by reference in this Form 10K, including our consolidated financial statements and related notes. If any of the following risks or other risks which have not been identified or which we may believe are immaterial or unlikely, actually occur, our business, financial condition and results of operations could be harmed. This could cause the price of our stock to decline, and shareholders could lose part or all of their investment. This Form 10K contains forward-looking statements that involve risks and uncertainties, including statements about our future plans, objectives, intentions and expectations. Many factors, including those described below, could cause actual results to differ materially from those discussed in our forward-looking statements.

Our business strategy includes the continuation of significant growth plans, and our financial condition and results of operations could be negatively affected if we fail to grow or fail to manage our growth effectively.

We intend to continue pursuing a significant growth strategy for our business. Our prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in significant growth stages of development. We cannot assure you we will be able to expand our market presence in our existing markets or successfully enter new markets or that any such expansion will not adversely affect our results of operations. Failure to manage our growth effectively could have a material adverse effect on our business, future prospects, financial condition or results of operations, and could adversely affect our ability to successfully implement our business strategy. Also, if our growth occurs more slowly than anticipated or declines, our operating results could be materially adversely affected.

Our business is subject to the success of the local economies where we operate.

Our success significantly depends upon the growth in population, income levels, deposits and housing starts in our primary and secondary markets. If the communities in which we operate do not grow or if prevailing economic conditions locally or nationally are unfavorable, our business may not succeed. Adverse economic conditions in our specific market area could reduce our growth rate, affect the ability of our customers to repay their loans to us and generally affect our financial condition and results of operations. We are less able than a larger institution to spread the risks of unfavorable local economic conditions across a large number of diversified economies. Moreover, we cannot give any assurance we will benefit from any market growth or favorable economic conditions in our primary market areas if they do occur.

Any adverse market or economic conditions in Virginia and North Carolina may disproportionately increase the risk that our borrowers will be unable to make their loan payments. In addition, the market value of the real estate securing loans as collateral could be adversely affected by unfavorable changes in market and economic conditions. Any sustained period of increased payment delinquencies, foreclosures or losses caused by adverse market or economic conditions in Virginia and North Carolina could adversely affect the value of our assets, our revenues, results of operations and financial condition.

We may face risks with respect to future expansion.

As a strategy, we have sought to increase the size of our franchise by aggressively pursuing business development opportunities, and we have grown rapidly since our incorporation. We have purchased a number of banking offices of other financial institutions as a part of that strategy and have acquired a number of insurance agencies. We may acquire other financial institutions and insurance agencies or parts of those entities in the future. Acquisitions and mergers involve a number of risks, including:

- the time and costs associated with identifying and evaluating potential acquisitions and merger partners;
- the estimates and judgments used to evaluate credit, operations, management and market risks with respect to the target entity may not be accurate;
- the time and costs of evaluating new markets, hiring experienced local management and opening new offices, and the time lags between these activities and the generation of sufficient assets and deposits to support the costs of the expansion;
- our ability to finance an acquisition and possible ownership and economic dilution to our current shareholders and to investors purchasing common stock in this offering;
- the diversion of our management's attention to the negotiation of a transaction, and the integration of the operations and personnel of the combining businesses;
- entry into new markets where we lack experience;
- the introduction of new products and services into our business;
- the incurrence and possible impairment of goodwill associated with an acquisition and possible adverse short-term effects on our results of operations; and
- the risk of loss of key employees and customers.

We may incur substantial costs to expand, and we can give no assurance such expansion will result in the levels of profits we seek. There can be no assurance integration efforts for any future mergers or acquisitions will be successful. Also, we may issue equity securities, including common stock, and securities convertible into shares of our common stock in connection with future acquisitions, which could cause ownership and economic dilution to our current shareholders. There is no assurance that, following any future mergers or acquisition, our integration efforts will be successful or our company, after giving effect to the acquisition, will achieve profits comparable to or better than our historical experience.

If the value of real estate in our core market areas were to decline materially, a significant portion of our loan portfolio could become under-collateralized, which could have a material adverse effect on us.

With most of our loans concentrated in the Richmond and Greater Metropolitan Hampton Roads areas of Virginia and the coastal and eastern Piedmont region of North Carolina, a decline in local economic conditions could adversely affect the values of our real estate collateral. Consequently, a decline in local economic conditions may have a greater effect on our earnings and capital than on the earnings and capital of larger financial institutions whose real estate loan portfolios are geographically diverse.

In addition to the financial strength and cash flow characteristics of the borrower in each case, the bank often secures loans with real estate collateral. At December 31, 2007, approximately 80% of the bank's loans have real estate as a primary or secondary component of collateral. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values, our earnings and capital could be adversely affected.

An inadequate allowance for loan losses would reduce our earnings and capital.

Our loan losses could exceed the allowance for loan losses we have set aside. Our average loan size continues to increase. Reliance on historic loan loss experience may not be indicative of future loan losses. Approximately 78.0% of our loan portfolio is composed of construction, acquisition and development, commercial mortgage and commercial and industrial loans. Repayment of such loans is generally considered more subject to market risk than residential mortgage loans. Industry experience shows that a portion of loans will become delinquent and a portion of the loans will require partial or entire charge-off. Regardless of the underwriting criteria we utilize, losses may be experienced as a result of various factors beyond our control, including, among other things, changes in market conditions affecting the value of our loan collateral and problems affecting the credit of our borrowers.

Management makes various assumptions and judgments about the ultimate collectibility of the loan portfolio and provides an allowance for loan losses based upon a percentage of the outstanding balances and for specific loans when their ultimate collectibility is considered questionable. If management's assumptions and judgments prove to be incorrect and the allowance for loan losses is inadequate to absorb losses, or if the bank regulatory authorities require the bank to increase the allowance for loan losses as a part of their examination process, the bank's earnings and capital could be significantly and adversely affected.

A significant part of our loan portfolio is unseasoned.

Since the beginning of 2006, our loan portfolio has more than doubled in size, growing by approximately $856 million. It is difficult to assess the future performance of this part of our loan portfolio due to the recent origination of these loans. Industry experience shows that it takes several years for loan difficulties to become apparent. We can give no assurance that these loans will not become non-performing or delinquent, which could adversely affect our future performance.

Our reliance on time deposits, including out-of-market certificates of deposit, as a source of funds for loans and our other liquidity needs could have an adverse effect on our operating results.

Among other sources of funds, we rely heavily on deposits for funds to make loans and provide for our other liquidity needs. However, our loan demand has exceeded the rate at which we have been able to build core deposits so we have relied heavily on time deposits, including out-of-market certificates of deposit, as a source of funds. Those deposits may not be as stable as other types of deposits and, in the future, depositors may not renew those time deposits when they mature, or we may have to pay a higher rate of interest to attract or keep them or to replace them with other deposits or with funds from other sources. Not being able to attract those deposits or to keep or replace them as they mature would adversely affect our liquidity. Paying higher deposit rates to attract, keep or replace those deposits could have a negative effect on our interest margin and operating results.

The building of market share through our de novo financial center strategy could cause our expenses to increase faster than our revenues.

We intend to continue to build market share through our de novo financial center strategy. During 2007, we opened two new financial centers in Raleigh, North Carolina and our first financial center in Wilmington, North Carolina. We currently intend to open five additional new financial centers in 2008. There are considerable costs involved in opening financial centers. New financial centers generally do not generate sufficient revenues to offset their costs until they have been in operation for at least a year or more. Accordingly, our new financial centers can be expected to negatively impact our earnings for some period of time until the financial centers reach certain economies of scale. Our expenses could be further increased if we encounter delays in the opening of any of our new financial centers. Finally, we have no assurance our new financial centers will be successful even after they have been established.

Our recent results may not be indicative of our future results.

We may not be able to sustain our historical rate of growth or may not even be able to grow our business at all. In addition, our recent and rapid growth may distort some of our historical financial ratios and statistics. In the future, we may not have the benefit of several recently favorable factors, such as a generally stable interest rate environment, a strong residential mortgage market, or the ability to find suitable expansion opportunities. Various factors, such as economic conditions, regulatory and legislative considerations and competition, may also impede or prohibit our ability to expand our market presence. If we experience a significant decrease in our historical rate of growth, our results of operations and financial condition may be adversely affected due to a high percentage of our operating costs being fixed expenses.

We may be adversely affected by interest rate changes.

Changes in interest rates may affect our level of interest income, the primary component of our gross revenue, as well as the level of our interest expense, our largest recurring expenditure. Net interest income is the difference between income from interest-earning assets, such as loans, and the expense of interest-bearing liabilities, such as deposits and our borrowings, including our outstanding junior subordinated debentures. We may not be able to effectively manage changes in what we charge as interest on our earning assets and the expense we must pay on interest-bearing liabilities, which may significantly reduce our earnings. The Federal Reserve has made significant reductions in interest rates during the first quarter of 2008. Since rates charged on loans often tend to react to market conditions faster than do rates paid on deposit accounts, these rate changes are expected to have a negative impact on our earnings until we can make appropriate adjustments in our deposit rates. In addition, there are costs associated with our risk management techniques, and these costs could be material. Fluctuations in interest rates are not predictable or controllable and, therefore, there can be no assurances of our ability to continue to maintain a consistent positive spread between the interest earned on our earning assets and the interest paid on our interest-bearing liabilities.

Our operations and customers might be affected by the occurrence of a natural disaster or other catastrophic event in our market area.

Because substantially all of our loans are with customers and businesses located in the central and coastal portions of Virginia and North Carolina, catastrophic events, including natural disasters, such as hurricanes which historically have struck the east coast of the United States with some regularity, or terrorist attacks, could disrupt our operations. Any of these natural disasters or other catastrophic events could have a negative impact on most or all of our offices and customer base, as well as the strength of our loan portfolio. Even though we carry business interruption insurance policies, make contingency plans and typically have provisions in our contracts that protect us in certain events, we might suffer losses as a result of business interruptions that exceed the coverage available under our insurance policies or for which we do not have coverage. Any natural disaster or catastrophic event affecting us could have a significant negative impact on our operations.

Competition from financial institutions and other financial service providers may adversely affect our profitability.

The banking business is highly competitive and we experience competition in each of our markets from many other financial institutions. We compete with commercial banks, credit unions, savings and loan associations, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market funds, and other mutual funds, as well as other super-regional, national and international financial institutions that operate offices in our primary market areas and elsewhere.

We compete with these institutions both in attracting deposits and in making loans. In addition, we have to attract our customer base from other existing financial institutions and from new residents. Many of our competitors are well-established, larger financial institutions. While we believe we can and do successfully compete with these other financial institutions in our primary markets, we may face a competitive disadvantage as a result of our smaller size, lack of geographic diversification and inability to spread our marketing costs across a broader market. Although we compete by concentrating our marketing efforts in our primary markets with local advertisements, personal contacts, and greater flexibility and responsiveness in working with local customers, we can give no assurance this strategy will be successful.

We are subject to extensive regulation that could limit or restrict our activities.

We are a public company that operates in a highly regulated industry and are subject to examination, supervision, and comprehensive regulation by various federal and state agencies. Our compliance with these regulations is costly and restricts certain of our activities, including payment of dividends, mergers and acquisitions, investments, loans and interest rates charged, interest rates paid on deposits and locations of offices. We are also subject to capitalization guidelines established by our regulators, which require us to maintain adequate capital to support our growth.

The laws and regulations applicable to public companies and the banking industry could change at any time, and we cannot predict the effects of these changes on our business and profitability. Because government regulation greatly affects the business and financial results of all commercial banks and bank and financial holding companies, our cost of compliance could adversely affect our ability to operate profitably.

Our directors and executive officers own a significant portion of our common stock

Our directors and executive officers, as a group, beneficially owned approximately 15% of our outstanding common stock as of December 31, 2007 (approximately 21% upon the exercise of outstanding vested options). As a result of their ownership, the directors and executive officers will have the ability, by voting their shares in concert, to significantly influence the outcome of all matters submitted to our shareholders for approval, including the election of directors.

Our continued success is dependent upon the services of our management team.

Our future success and profitability is substantially dependent upon the management and banking abilities of our senior executives. We believe that our continued growth and future results will depend in part upon our attracting and retaining highly skilled and qualified management and sales and marketing personnel. Competition for such personnel is intense, and we cannot assure you that we will be successful in attracting or retaining such personnel. We also cannot guarantee that members of our executive management team will remain with us. Changes in key personnel and their responsibilities may be disruptive to our business and could have a material adverse effect on our business, financial condition and results of operations.

Our continued pace of growth may require us to raise additional capital in the future, but that capital may not be available when it is needed.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. During 2007 we issued $26.2 million of common stock and $25 million in trust preferred securities to acquire The Bank of Richmond, N.A. Additionally, we conducted a private placement of $23.3 million in preferred stock to support our continued growth. We may at some point need to again raise additional capital to support our continued growth. Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time, which are outside our control, and on our financial performance. Accordingly, we cannot assure you of

our ability to raise additional capital if needed on terms acceptable to us. If we cannot raise additional capital when needed, our ability to further expand our operations through internal growth and acquisitions could be materially impaired.

Our future capital needs could result in dilution of your investment.

Our board of directors may determine from time to time there is a need to obtain additional capital through the issuance of additional shares of our common stock or other securities. These issuances would likely dilute the ownership interests of the investors in this offering and may dilute the per share book value of our common stock. New investors may also have rights, preferences and privileges senior to our current shareholders which may adversely impact our current shareholders.

The trading volume in our common stock is low and the sale of substantial amounts of our common stock in the public market could depress the price of our common stock.

The average daily trading volume of our shares on The Nasdaq Global Select Market for the three months ended March 10, 2008 was approximately 32,000 shares. Lightly traded stock can be more volatile than stock trading in an active public market. We cannot predict the extent to which an active public market for our common stock will develop or be sustained. During the last half of 2007, the market prices for the securities of many banks and bank holding companies have experienced wide price fluctuations that have not necessarily been related to their operating performance. Therefore, our shareholders may not be able to sell their shares at the volumes, prices, or times that they desire.

We cannot predict the effect, if any, that future sales of our common stock in the market, or availability of shares of our common stock for sale in the market, will have on the market price of our common stock. We therefore can give no assurance that sales of substantial amounts of our common stock in the market, or the potential for large amounts of sales in the market, would not cause the price of our common stock to decline or impair our ability to raise capital through sales of our common stock.

Our ability to pay dividends is limited and we may be unable to pay future dividends.

Our ability to pay dividends is limited by regulatory restrictions and the need to maintain sufficient consolidated capital. The ability of our bank subsidiary to pay dividends to us is limited by their obligations to maintain sufficient capital and by other general restrictions on their dividends under federal and state bank regulatory requirements. If we do not satisfy these regulatory requirements, we will be unable to pay dividends on our common stock.

Holders of our junior subordinated debentures have rights that are senior to those of our common shareholders.

We have supported our continued growth through the issuance of trust preferred securities from special purpose trusts and accompanying junior subordinated debentures. At December 31, 2007, we had outstanding trust preferred securities and accompanying junior subordinated debentures totaling $56.1 million. Payments of the principal and interest on the trust preferred securities of this special purpose trust are conditionally guaranteed by us. Further, the accompanying junior subordinated debentures we issued to the special purpose trust are senior to our shares of common stock. As a result, we must make payments on the junior subordinated debentures before any dividends can be paid on our common stock and, in the event of our bankruptcy, dissolution or liquidation, the holders of the junior subordinated debentures must be satisfied before any distributions can be made on our common stock. We have the right to defer distributions on our junior subordinated debentures (and the related trust preferred securities) for up to five years, during which time no dividends may be paid on our common stock.

Certain provisions under our Articles of Incorporation and applicable law may make it difficult for others to obtain control of our corporation even if such a change in control may be favored by some shareholders.

Certain provisions in our Articles of Incorporation and applicable North Carolina corporate and banking law may have the effect of discouraging a change of control of GFH even if such a transaction is favored by some of our shareholders and could result in shareholders receiving a substantial premium over the current market price of our shares. The primary purpose of these provisions is to encourage negotiations with our management by persons interested in acquiring control of our corporation. These provisions may also tend to perpetuate present

Table of Contents

management and make it difficult for shareholders owning less than a majority of the shares to be able to elect even a single director.

Our securities are not FDIC insured.

Our common stock is not a savings or deposit account or other obligation of the bank, and is not insured by the Bank Insurance Fund of Federal Deposit Insurance Corporation or any other governmental agency and is subject to investment risk, including the possible loss of principal.

ITEM 1B – UNRESOLVED STAFF COMMENTS

None.

ITEM 2 – PROPERTIES

The Company currently operates out of the banking and insurance offices as set forth below:

Office Location	Approximate Square Footage	Year Established/ Acquired
Edenton - 322 S Broad St (4)	5,400	2006
Elizabeth City – 112 Corporate Dr (6)	25,000	2006
Elizabeth City - 1145 N Road St (1)	9,000	1999
Elizabeth City - 1404 W Ehringhaus St (3)	2,000	2003
Elizabeth City – 400 W Ehringhaus St (4)	5,000	2004
Elizabeth City – 802 W Ehringhaus St (2)	3,200	2004
Hertford - 147 N Church St (2)	2,000	2002
Kitty Hawk - 3600 Croatan Hwy (1)	6,500	2002
Kitty Hawk - 5406 Croatan Hwy (1)	4,200	2006
Moyock - 100 Moyock Commons Dr (4)	4,000	2004
Nags Head - 2808 @ Croatan Hwy (5)	4,800	2004
Plymouth - 433 US Hwy 64 E (4)	5,200	2000
Raleigh - 2209 Century Dr (3)	2,500	2006
Raleigh -8470 Falls of Neuse Rd (3)	4,486	2007
Raleigh - 2235 Access Medical Dr (3)	46,989	2007
Roper - 102 W Buncomb St (3)	550	2000
Wilmington - 901 Military Cutoff Rd (3)	7,600	2007
Chesapeake - 111 Gainsboro Square (5)	7,200	2002
Chesapeake - 575 Cedar Rd (3)	2,400	2003
Chesapeake - 1403 Greenbrier Parkway (3)	3,800	2006
Emporia - 5205 Main St (3)	6,500	2004
Midlothian - 13804 Hull St (3)	5,928	2007
Newport News - 753 Thimble Shoals Blvd (2)	2,800	2006
Norfolk - 539 21st St (3)	10,000	2006
Richmond - 5300 Patterson Ave (3)	5,948	2007
Richmond - 2730 Buford Rd (3)	2,768	2007
Richmond - 8905 Fargo Rd (3)	1,568	2007
Richmond - 8209 W Broad St (3)	3,588	2007
Richmond - 12090 W Broad St (3)	9,462	2007
Suffolk - 2825 Godwin Dr (3)	3,200	2004
Virginia Beach - 4460 Corporation Lane Suite 100 (3)	4,000	2000
Virginia Beach - 713 Independence Blvd (3)	2,200	2003
Virginia Beach - 1580 Laskin Rd (5)	7,500	2005
Virginia Beach - 641 Lynnhaven Parkway (3)	20,000	2006
Virginia Beach - 3801 Pacific Ave (3)	1,200	2006

Office Location	Approximate Square Footage	Year Established/ Acquired
Virginia Beach - 2098 Princess Anne Rd (3)	2,500	2005
Virginia Beach - 3001 Shore Dr (3)	2,000	2003

(1) Includes banking, investment brokerage and insurance services.

(2) Insurance services only.

(3) Banking services only.

(4) Only banking and insurance services.

(5) Only banking and investment brokerage services.

(6) Operations building.

The properties we own, including land, buildings and improvements, furniture, equipment and vehicles, had a net book value at December 31, 2007 of $73.6 million. In the opinion of the Company's management, such properties are adequately covered by insurance, are in good operating condition, ordinary wear and tear excepted, and are adequate and suitable for the ordinary and regular conduct and operation of our business.

ITEM 3 – LEGAL PROCEEDINGS

The Company is aware of no material legal proceeding to which the Company or any of its subsidiaries is a party or of which any of their properties is subject.

ITEM 4 – SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5 – MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the Nasdaq Global Select Market under the symbol "GBTS". The following table sets forth the high and low published closing prices for shares of our common stock for the periods indicated. Where appropriate, prices have been adjusted for the effects of an 11-for-10 stock split in the form of a 10% stock dividend payable May 15, 2006 to holders of record as of the close of business on April 28, 2006. The last reported sales price of the common stock on March 10, 2008 was $10.14 per share. As of December 31, 2007, Gateway Bank had approximately 5,600 shareholders of record.

		High	Low	Dividend
2006	First Quarter	$15.74	$14.90	$0.03
	Second Quarter	15.69	14.45	0.03
	Third Quarter	15.01	14.01	0.05
	Fourth Quarter	14.73	13.95	0.05
2007	First Quarter	$14.44	$13.80	$0.05
	Second Quarter	14.71	13.17	0.08
	Third Quarter	15.83	12.74	0.08
	Fourth Quarter	14.41	11.85	0.08

As a holding company, we are dependent upon our subsidiary, Gateway Bank, to provide funding for our operating expenses and dividends. North Carolina banking law will permit the payment of dividends only out of retained earnings and will prohibit the payment of cash dividends if payment of the dividend would cause Gateway Bank's surplus to be less than 50% of its paid-in capital. Also, under federal banking law, no cash dividend may be paid if

Gateway Bank is undercapitalized or insolvent or if payment of the cash dividend would render Gateway Bank undercapitalized or insolvent, and no cash dividend may be paid by Gateway Bank if it is in default of any deposit insurance assessment due to the FDIC. Subject to these restrictions, our Board of Directors will consider the payment of dividends when it is deemed prudent to do so.

The Company's stock repurchase program, as approved by the Board of Directors on April 30, 2007, provides for the purchase of up to 500,000 shares. There have been 400,637 shares purchased under the 2007 plan during the year ended December 31, 2007.

The following table presents information with respect to shares of common stock repurchased by the Company during the forth quarter of 2007

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Number of Shares That May Yet Be Purchased Under the Program (1)
October 1, 2007 to October 31, 2007	—	$ —	—	200,000
November 1, 2 007 to November 30, 2007	—	—	—	200,000
December 1, 2007 to December 31, 2007	100,637	12.33	100,637	99,363
Total	100.637	$ 12.33	100,637	99,363

Table of Contents

ITEM 6 – SELECTED FINANCIAL DATA

The information presented below is derived in part from the audited consolidated financial statements and notes thereto of the Company. This information presented below does not purport to be complete and should be read in conjunction with the Company's consolidated financial statements appearing elsewhere in this annual report.

	For the Years Ended December 31,				
	2007	2006	2005	2004	2003
	(Dollars in thousands, except per share data)				
Operating Data:					
Total interest income	$ 109,559	$ 73,097	$ 39,679	$ 19,632	$ 13,486
Total interest expense	60,474	36,099	16,376	6,691	5,341
Net interest income	49,085	36,998	23,303	12,941	8,145
Provision for loan losses	4,900	3,400	2,200	1,425	1,200
Net interest income after provision for loan losses	44,185	33,598	21,103	11,516	6,945
Total non-interest income	17,765	9,270	8,067	5,857	4,485
Total non-interest expense	44,941	34,974	23,266	14,653	10,230
Income before income taxes	17,009	7,894	5,904	2,720	1,200
Provision for income taxes	5,990	2,625	1,965	710	—
Net income	$ 11,019	$ 5,269	$ 3,939	$ 2,010	$ 1,200
Per Share Data: (1)					
Net income basic	$ 0.91	$ 0.49	$ 0.48	$ 0.37	$ 0.30
Net income diluted	0.89	0.47	0.46	0.34	0.29
Dividends	0.29	0.16	0.09	0.02	—
Book value per common share	11.24	9.99	9.46	7.98	6.20
Tangible book value per common share	7.17	8.84	8.4	7 6.66	5.31
Balance Sheet Data:					
Total assets	$1,868,185	$1,207,477	$883,373	$535,728	$314,826
Loans receivable	1,522,401	994,592	666,652	381,956	231,740
Allowance for loan losses	15,339	9,405	6,283	4,163	2,759
Deposits	1,408,919	923,725	646,262	406,259	238,452
Borrowings	282,102	166,929	134,665	63,926	50,000
Stockholders' equity	164,407	109,640	98,744	64,318	24,971
Selected Performance Ratios:					
Return on average assets	0.71%	0.51%	0.58%	0.49%	0.43%
Return on average equity	8.45%	5.06%	5.77%	5.12%	4.93%
Net interest margin (2)	3.49%	3.87%	3.81%	3.59%	3.24%
Net interest spread (3)	3.12%	3.35%	3.44%	3.33%	2.98%
Non-interest income as a percentage of net interest income and non-interest income	26.57%	20.04%	25.72%	31.16%	35.51%
Non-interest income as a percentage of average assets	1.15%	0.89%	1.19%	1.44%	1.61%
Non-interest expense to average assets	2.90%	3.35%	3.43%	3.59%	3.67%
Efficiency ratio (4)	67.23%	75.80%	74.17%	77.95%	81.00%

	For the Years Ended December 31,				
	2007	2006	2005	2004	2003
	(Dollars in thousands, except per share data)				
Asset Quality Ratios:					
Nonperforming loans to period-end loans	0.22%	0.33%	0.03%	0.13%	0.52%
Allowance for loan losses to period-end loans	1.01%	0.95%	0.94%	1.09%	1.19%
Allowance for loan losses to nonperforming loans	450.22%	287.70%	3079.90%	849.59%	228.02%
Nonperforming assets to total assets (5)	0.21%	0.27%	0.02%	0.09%	0.38%
Net loan charge-offs to average loans outstanding	0.09%	0.04%	0.02%	0.01%	0.11%
Capital Ratios: (6)					
Total risk-based capital	11.40%	12.99%	15.17%	17.40%	12.68%
Tier 1 risk-based capital	10.43%	12.11%	14.31%	16.41%	11.59%
Leverage ratio	9.76%	11.38%	13.73%	13.89%	9.33%
Equity to assets ratio	8.80%	9.08%	10.19%	12.01%	7.93%
Other Data:					
Number of banking offices	33	24	18	16	10
Number of full time equivalent employees	420	327	247	191	123

(1) Restated for 11 –for- 10 stock split in 2006, 11 –for- 10 stock split in 2005, 21-for-20 stock split in 2004, and 21-for-20 stock split occurring during 2003.

(2) Net interest margin is net interest income divided by average interest-earning assets.

(3) Net interest spread is the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.

(4) Efficiency ratio is non-interest expense divided by the sum of net interest income and non-interest income.

(5) Nonperforming assets consists of nonaccrual loans, restructured loans, and real estate owned, where applicable.

(6) Capital ratios are for the Company.

ITEM 7 – MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

AND

ITEM 7A — QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The purpose of this discussion is to focus on significant changes in the financial condition and results of operation of the company during the past three years. The discussion and analysis are intended to supplement and highlight information contained in the accompanying consolidated financial statements and the selected financial data presented elsewhere in this Annual Report on Form 10-K. Prior period information has been restated as applicable in order to provide the reader a better comparison between periods.

FORWARD LOOKING STATEMENTS

Statements contained in this annual report, which are not historical facts, are forward-looking statements, as that term is defined in the Private Securities Litigation Reform Act of 1995. Amounts herein could vary as a result of market and other factors. Such forward-looking statements are subject to risks and uncertainties which could cause actual results to differ materially from those currently anticipated due to a number of factors, which include, but are not limited to, factors discussed in documents filed by the Company with the Securities and Commission from time to time. Such forward-looking statements may be identified by the use of such words as "believe," "expect," "anticipate," "should," "planned," "estimated," and "potential." Examples of forward-looking statements include, but are not limited to, estimates with respect to the financial condition, expected or anticipated revenue, results of operations and business of the Company that are subject to various factors which could cause actual results to differ

materially from these estimates. These factors include, but are not limited to, general economic conditions, changes in interest rates, deposit flows, loan demand, real estate values, and competition; changes in accounting principles, policies, or guidelines; changes in legislation or regulations; and other economic, competitive, governmental, regulatory, and technological factors affecting the Company's operations, pricing, products and services.

Management's discussion and analysis is intended to assist readers in the understanding and evaluation of the financial condition and results of operations of Gateway Financial Holdings, Inc. It should be read in conjunction with the audited consolidated financial statements and accompanying notes included in this annual report and the supplemental financial data appearing throughout this discussion and analysis. On April 25, 2006 the Company's Board of Directors declared an 11– for-10 stock split effected in the form of a 10% stock dividend, which was distributed May 15, 2006 to stockholders of record on April 28, 2006. On May 16, 2005 the Company's Board of Directors declared an 11– for-10 stock split effected in the form of a 10% stock dividend, which was distributed June 20, 2005 to stockholders of record on May 30, 2005. All references in this discussion and analysis to per share results and weighted average shares outstanding have been adjusted to reflect the effects of these stock splits.

OVERVIEW

Gateway Financial Holdings, Inc. is a financial holding company incorporated under the laws of North Carolina to serve as the holding company for Gateway Bank & Trust Co., a North Carolina chartered commercial bank. The bank began operations on December 1, 1998 and, effective October 1, 2001, became our wholly owned subsidiary.

Since inception, we have aggressively pursued the primary objective of building a full-service commercial banking operation, while effectively supplementing our banking activities with other financial services intended to generate significant non-interest income. Accordingly, a key component of our growth strategy has been expanding our franchise through the opening of newly constructed financial centers and strategic financial center acquisitions. We have grown into a regional community bank with a total of thirty-three full-service financial centers — nineteen in Virginia: Virginia Beach (7), Richmond (6), Chesapeake (3), Suffolk, Norfolk and Emporia; and fourteen in North Carolina: Elizabeth City (3), Edenton, Kitty Hawk (2), Raleigh (3), Moyock, Nags Head, Plymouth, Roper, and Wilmington. We acquired The Bank of Richmond, N.A., effective June 1, 2007, and operate the six financial centers in the Richmond metropolitan area and one loan production office in Charlottesville, Virginia, under the assumed name "The Bank of Richmond." Consistent with our long-range strategic objectives, we will continue to consider acquisition opportunities including whole bank or financial center locations. We will also continue to explore de novo financial center opportunities in markets that we consider attractive. We currently intend to open five additional new financial centers in 2008, including our first financial centers in Chapel Hill and Wake Forest, North Carolina, and Charlottesville and Lynchburg, Virginia, as well as our second office in Emporia, Virginia

The bank has four wholly-owned operating subsidiaries, which have contributed to our market presence. Gateway Insurance Services, Inc., an insurance agency with offices in Edenton, Hertford, Elizabeth City, Plymouth, Moyock and Kitty Hawk, North Carolina, and the Hampton Roads area of Virginia, sells insurance products to businesses and individuals. Gateway Investment Services, Inc., assists Bank customers in their securities brokerage activities through an arrangement with an unaffiliated broker-dealer. As prescribed by this arrangement, Gateway Investment Services earns revenue through a commission sharing arrangement with the unaffiliated broker-dealer. Gateway Bank Mortgage, Inc., provides mortgage banking services with products that are sold on the secondary market. Gateway Title Agency, Inc., engages in title insurance and settlement services for real estate transactions. In an ongoing effort to create significant sources of non-interest income, we will continue to look for ways to expand non-traditional banking activities in our insurance and investment services subsidiaries.

Since inception, we have concentrated our efforts on building a franchise and infrastructure that can deliver and sustain long-term profitability. We have been profitable for twenty-four consecutive quarters, producing net income of $3.9 million in 2005, $5.3 million in 2006, and $11.0 million during the year ended December 31, 2007. While we anticipate continued profitability, future expansion activity can be expected to generate significant additional costs that can negatively impact earnings as we pursue our growth strategies.

In addition to our banking activities, the Bank has focused on insurance, mortgage and brokerage services to develop sustainable and growth-oriented sources of non-interest income. In the fourth quarter of 2006 Gateway Insurance Services acquired two agencies in Virginia (The Insurance Center and C D West & Company) opening the door for further expansion in the Hampton Roads area of Virginia. In February 2007, The Bank acquired Gateway Title Agency, Inc., which engages in title insurance and settlement services for real estate transactions. In addition, the Bank organized Gateway Investment Services in September 1999 to assist customers in their securities brokerage activities through a networking arrangement with an unaffiliated broker-dealer. Through this arrangement, Gateway

Investment Services earns revenues through commission sharing from the unaffiliated broker-dealer. In June 2006 we opened our wholly owned mortgage origination company in Raleigh, North Carolina with offices also in Elizabeth City, and Kitty Hawk, North Carolina and offices in Norfolk and Virginia Beach, Virginia. The Bank will continue to look for ways to expand non-traditional banking activities in its insurance subsidiary and securities networking arrangement, which create significant sources of non-interest income.

FINANCIAL CONDITION
December 31, 2007 and 2006

The Company continued its pattern of steady growth during 2007, with total assets increasing by $660.7 million, or 54.7%, to $1.87 billion at December 31, 2007 from $1.2 billion at December 31, 2006. This growth was principally driven by increased loans from our franchise expansion, the completion of our acquisition of The Bank of Richmond on June 1, 2007, the purchase of investment securities used primarily for balance sheet management and liquidity purposes, and the purchase of premises and equipment associated with the opening of three de novo financial centers during the second half of 2007, including a regional headquarters building in Raleigh, North Carolina. Assets acquired through the acquisition of The Bank of Richmond aggregated $235.7 million, including $36.7 million of goodwill. Total loans increased by $527.8 million, or 53.1%, from $994.6 million at December 31, 2006 to $1.5 billion at December 31, 2007. Of this increase, $168.0 million was related to loans from the acquisition of The Bank of Richmond. Therefore, organic loan growth for 2007 aggregated $359.8 million or 36.2%. This increase was attributed to the seasoning of our financial centers and our private banking center during the year and the steady economies of the markets in which we operate. The increases in loans were comprised principally of increases of $222.5 million, $124.4 million, and $92.1 million of construction, acquisition and development, commercial and industrial, and commercial real estate loans, respectively – areas of lending that the Company targets. This growth was concentrated mainly in the Raleigh and Wilmington North Carolina and Richmond and greater Hampton Roads areas of Virginia. As of December 31, 2007, 78.0% of our loan portfolio was represented by commercial, industrial, real estate, and construction and acquisition and development loans. The Company has maintained liquidity at what it believes to be an appropriate level. Liquid assets, consisting of cash and due from banks, interest-earning deposits in other banks and trading and investment securities available for sale, were $170.4 million, or 9.1% of total assets, at December 31, 2007 as compared to $120.3 million, or 10.0% of total assets at December 31, 2006.

Funding for the growth in assets and loans was provided by an increase in deposits of $485.2 million to $1.4 billion, and an increase in total borrowings of $115.2 million. Of the increase in deposits, $177.6 million was related to deposits from the acquisition of The Bank of Richmond. Therefore, non-acquisition related deposits grew $307.6 million or 33.3%, from $923.7 million at December 31, 2006. Non-interest-bearing demand deposits increased by 14.7% or $15.9 million to $123.9 million from the $108.0 million balance at December 31, 2006. Savings, money market and NOW accounts increased by 49.8% or $133.9 million to $402.5 million, from the $268.7 million balance at December 31, 2006. These increases resulted from the maturing of our branch network, especially those financial centers opened during the last half of the year in Wilmington and Raleigh, North Carolina. Additionally, we introduced a new "Platinum" money market account during the second quarter of 2007, and an U-sweep and Clear Advantage NOW account during the fourth quarter of 2007 that has been very successful, as well as, our low cost business checking and sweep account programs. Time deposits totaled $882.5 million at December 31, 2007 as compared to $547.1 million at December 31, 2006. This increase of $335.5 million was driven primarily by retail CDs special offerings that are very competitive in our market place, an increase in brokered CDs of $130.7 million, and CD’s related to the acquisition of The Bank of Richmond of $125.8 million. Time deposits of more than $100,000 were $271.3 million, or 19.3% of total deposits at December 31, 2007 as compared with $205.5 million, or 22.2% of total deposits at December 31, 2006. The Company continued using brokered deposits to fund growth. The total brokered time deposits increased to $225.9 million as of December 31, 2007 compared to $95.2 million at December 31, 2006. As a percentage of total deposits, our brokered deposits increased to 16.0% of total deposits as compared to 10.3% at December 31, 2006. Brokered deposits were used primarily to fund loan growth in our loan production offices in Wilmington, Greenville and Chapel Hill, North Carolina, and Charlottesville, Virginia; and our private banking center in Raleigh. Loans for these offices aggregated $429.3 million as of December 31, 2007, an increase of $248.4 million during 2007. As of December 31, 2007 we had $282.1 million in total borrowings outstanding, as compared with $166.9 million outstanding at December 31, 2006. The Company issued an additional $25.7 million of junior subordinated debentures (commonly referred to as trust preferred securities) during the second quarter of 2007 which was used to fund the cash portion of the consideration for The Bank of Richmond acquisition. Additionally, the Company borrowed an additional $58 million from the Federal Home Loan Bank of Atlanta during 2007 that supported our loan and franchise growth not covered by deposit growth. These advances were primarily five year convertible advances with call provisions that provided a lower cost of funding.

Total stockholders' equity increased by $54.8 million to $164.4 million from December 31, 2006, primarily as a result of issuing approximately 1.85 million shares of Company stock to fund the stock portion of the consideration to acquire The Bank of Richmond, the issuance of $23.2 million of non-cumulative perpetual preferred stock in a private placement in December 2007, and net income of $11.0 million; offset by cash dividends of $3.5 million during the year, and the repurchase and retirement of $5.6 million of its common stock. The capital ratios of the Company and the Bank continue to be in excess of the minimums required to be deemed well-capitalized by regulatory authorities.

NET INTEREST INCOME

Like most financial institutions, the primary component of earnings for the Company is net interest income. Net interest income is the difference between interest income, principally from loan and investment securities portfolios, and interest expense, principally on customer deposits and borrowings. Changes in net interest income result from changes in volume, spread and margin. For this purpose, volume refers to the average dollar level of interest-earning assets and interest-bearing liabilities, spread refers to the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities, and margin refers to net interest income divided by average interest-earning assets and is influenced by the level and relative mix of interest-earning assets and interest-bearing liabilities, as well as levels of non-interest-bearing liabilities. During the years ended December 31, 2007, 2006 and 2005, average interest-earning assets were $1.4 billion, $956.8 million and $611.1 million, respectively. During these same years, the Company's net interest margins were 3.49%, 3.87% and 3.81%, respectively.

Average Balances and Average Rates Earned and Paid. The following table sets forth, for the periods indicated, information with regard to average balances of assets and liabilities, as well as the total dollar amounts of interest income from interest-earning assets and interest expense on interest-bearing liabilities, resultant yields or costs, net interest income, net interest spread, net interest margin, and ratio of average interest-earning assets to average interest-bearing liabilities. In preparing the table, nonaccrual loans are included in the average loan balance.

	For the Years Ended December 31,								
	2007			2006			2005		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
	(Dollars in thousands)								
Interest-earning assets:									
Loans	$ 1,262,516	$ 102,041	8.08%	$ 835,527	$ 67,517	8.08%	$ 523,492	$ 36,358	6.95%
Interest-earning deposits	5,628	341	6.06%	2,707	140	5.17%	3,668	138	3.76%
Trading and investment securities available for sale taxable	113,777	5,909	5.19%	102,506	4,632	4.52%	72,579	2,731	3.76%
Investment securities available for sale tax exempt	11,243	423	3.76%	6,850	238	3.47%	6,327	204	3.22%
FHLB/FRB stock	12,594	845	6.71%	9,175	570	6.21%	5,038	248	4.92%
Total interest-earning assets	1,405,758	109,559	7.79%	956,765	73,097	7.64%	611,104	39,679	6.49%
Other assets	143,989			86,553			67,916		
Total assets	$ 1,549,747			$ 1,043,318			$ 679,020		
Interest-bearing liabilities:									
Deposits:									
Savings, NOW, and money market	$ 330,980	11,491	3.47%	$ 245,038	7,918	3.23%	$ 178,577	3,579	2.00%
Time deposits	751,226	38,103	5.07%	450,786	20,571	4.56%	267,494	9,115	3.41%
Borrowings	211,830	10,880	5.14%	145,725	7,610	5.22%	91,005	3,682	4.05%
Total interest-bearing liabilities	1,294,036	60,474	4.67%	841,549	36,099	4.29%	537,076	16,376	3.05%
Demand deposits	116,190			93,346			72,369		
Other liabilities	9,130			4,216			1,317		
Stockholders' equity	130,391			104,207			68,258		
Total liabilities and stockholders' equity	$ 1,549,747			$ 1,043,318			$ 679,020		
Net interest income and interest rate spread		$ 49,085	3.12%		$ 36,998	3.35%		$ 23,303	3.44%
Net interest margin			3.49%			3.87%			3.81%
Ratio of average interest-earning assets to average interest-bearing liabilities	108.63%			113.69%			113.78%		

RATE/VOLUME ANALYSIS

The following table analyzes the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities. The table distinguishes between (i) changes attributable to volume (changes in volume multiplied by the prior period's rate), (ii) changes attributable to rate (changes in rate multiplied by the prior period's volume), and (iii) net change (the sum of the previous columns). The change attributable to both rate and volume (changes in rate multiplied by changes in volume) has been allocated equally to both the changes attributable to volume and the changes attributable to rate.

	Year Ended December 31, 2007 vs. 2006			Year Ended December 31, 2006 vs. 2005		
	Increase (Decrease) Due to			Increase (Decrease) Due to		
	Volume	Rate	Total	Volume	Rate	Total
	(Dollars in thousands)					
Interest income:						
Loans	$ 34,507	$ 17	$ 34,524	$ 23,443	$ 7,716	$ 31,159
Interest-earning deposits	164	37	201	(43)	45	2
Trading and investment securities available for sale:						
Taxable	547	730	1,277	1,239	662	1,901
Tax-exempt	159	26	185	18	16	34
FHLB/FRB stock	221	54	275	230	92	322
Total interest income	35,598	864	36,462	24,887	8,531	33,418
Interest expense:						
Deposits:						
Savings, NOW, and money market	2,880	693	3,573	1,740	2,599	4,339
Time deposits	14,475	3,057	17,532	7,305	4,151	11,456
Borrowings	3,430	(160)	3,270	2,701	1,227	3,928
Total interest expense	20,785	3,590	24,375	11,746	7,977	19,723
Net interest income increase	$ 14,813	$ (2,726)	$ 12,087	$ 13,141	$ 554	$ 13,695

RESULTS OF OPERATIONS
Years Ended December 31, 2007 and 2006

Overview. The Company reported net income of $11.0 million or $0.89 per share (diluted) for the year ended December 31, 2007, as compared with net income of $5.3 million or $0.47 per share (diluted) for the year ended December 31, 2006, an increase of $5.8 million in net income and $0.42 in earnings per share (diluted). During 2007 cash dividends totaling $0.29 per share were paid as compared to $0.16 per share for the same period in 2006.

The results for both periods presented were affected by the fluctuations in fair value and net cash settlements on the economic hedge (interest rate swap) that it entered into in December 2005 to hedge the interest rate of its variable loan portfolio. Non-interest income included a gain and net cash settlements on the economic hedge of $584,000 for the year ended December 31, 2007, and a loss and net cash settlement on the economic hedge of $1.9 million for the year ended December 31, 2006, primarily as a result of fluctuations (both favorable and unfavorable) in the LIBOR swap interest rate and market conditions during the periods presented. The Company terminated its position in the economic hedge during the third quarter of 2007, and received a termination fee of $115,000 that was included in the above gain for 2007. The fair value of the interest rate swap can be volatile from quarter to quarter, and thus can affect net income positively or negatively depending on interest rate conditions and other factors. As a result of the Company terminating its position in the economic hedge, there will be no income or loss associated with the hedge going forward. Additionally, the results for 2007 included a fair value gain of $960,000 related to certain of its trust preferred debt securities that it had elected fair value option treatment effective January 1, 2007. This gain, which was included in other non-interest income, was the result of the unusual credit conditions the financial industry

faced during the last half of the year, which saw credit spreads on these types of securities widen significantly. It would not be anticipated that the Company would experience a fair value gain of this magnitude in the future, and in all likelihood would show a fair value loss if credit market conditions become more normalized.

The Company's primary focus (banking, mortgage loan origination, insurance, and investment services) continues to grow with de novo development of its branch network and subsidiary operations, and the completed acquisition of The Bank of Richmond on June 1, 2007. The acquisition and the opening of three de novo financial centers during the last half of the year (two in Raleigh, North Carolina and our first full financial center in Wilmington, North Carolina) increased our total financial centers to 33, along with a private banking center in Raleigh and four loan production offices. Our franchise has generated consistently high levels of net interest income and non-interest income since inception. During the year ended December 31, 2007, total revenue (defined as net interest income and non-interest income) increased $20.6 million or 44.5% to $66.9 million over the prior year. The significant increase in revenues was the primary reason for the increase in net income, partially offset by increases in non-interest expenses, loan loss provision, and income taxes. The Company has incurred additional non-interest expenses as a result of the franchise growth from period to period, increased FDIC insurance costs, higher franchise tax costs, and the acquisition of The Bank of Richmond (which increased non-interest expenses by approximately $2.4 million for the year ended December 31, 2007).

Net Interest Income. Total interest income increased to $109.6 million for the year ended December 31, 2007, a $36.5 million or 49.9% increase from the $73.1 million earned in 2006. Total interest income benefited from a 46.9% increase in average earning assets, driven primarily from a $427 million or 51.1% growth in average loans as compared with the prior year. The average yield on interest-earning assets increased 15 basis points from 7.64% to 7.79% due to restructuring the investment portfolio during the second quarter of this year, which increased the investment yield from 4.59% for the prior year to 5.22% for the year ended December 31, 2007. The yield on loans was flat year over year at 8.08%. However, loan yields in the fourth quarter of 2007 decreased to 7.93% from 8.20% for the fourth quarter of last year as a result of the 100 basis points cut in interest rate during the last four months of 2007. The current trend with interest rates is for them to continue to fall during the first part of 2008 with uncertainty as to which direction interest rates will take later in the year.

Average total interest-bearing liabilities increased by $452.5 million, or 53.8%, for the year ended December 31, 2007 as compared with the prior year, consistent with the increase in interest-earning assets. The average cost of interest-bearing liabilities increased by 38 basis points over the same time period from 4.29% to 4.67% primarily as a result of several factors including: (1) funding $130.7 million of the growth over the last 12 months (primarily from loan production offices and our private banking center) with wholesale brokered CD's (which typically have a higher all-in interest rate than bank core deposits); (2) our portfolio of CDs re-pricing upwards during the first half of the year as a result of interest rates continuing to increase due to competition for deposits, and (3) the introduction of a higher cost money market account and CD special during the second quarter of this year. Our costs for CD's increased from 4.56% in 2006 to 5.07% in 2007, and our interest bearing transaction accounts increased from 3.23% to 3.49%. The rise in the cost of interest-bearing liabilities mitigated somewhat during the fourth quarter, as costs for the fourth quarter only increased 9 basis points as compared with the fourth quarter of last year, primarily as a result of the drop in interest rates — which had an immediate effect or our short-term borrowings, and allowed us to immediately start re-pricing our interest bearing transaction deposit accounts. The cost of our transaction accounts decreased to 3.42% for the fourth quarter of this year as compared with 3.47% for the entire year and 3.43% for the fourth quarter of last year.

As a result of the leveling of loan yields, and the increase in funding costs as discussed above, the interest rate spread decreased 23 basis points from 3.35% for the year ended December 31, 2006 to 3.12% for the current year; and the net interest margin decreased 38 basis points from 3.87% for the year ended December 31, 2006 to 3.49% for 2007. Despite this drop in interest margin during 2007, net interest income increased $12.1 million or 32.7% in the current year over 2006, driven primarily by the increased volume of $427 million higher average loans in 2007 as compared with the prior year.

Provision for Loan Losses. The Company recorded a $4.9 million provision for loan losses for the year ended December 31, 2007, an increase of $1.5 million over the $3.4 million provision for loan losses recorded for the prior year. Provisions for loan losses are charged to income to bring the allowance for loan losses to a level deemed appropriate by Management. In evaluating the allowance for loan losses, Management considers factors that include growth, composition and industry diversification of the portfolio, historical loan loss experience, current delinquency levels, adverse situations that may affect a borrower's ability to repay, estimated value of any underlying collateral, prevailing economic conditions and other relevant qualitative factors. In both 2007 and 2006, the provision for loan losses was made principally in response to growth in loans, as well as changes in conditions

related to the above factors. Net charge-offs as a percentage of average loans increased to 0.09% for the year ended December 31, 2007 from 0.04% in the prior year; and the Company's level of nonperforming assets has increased slightly to $3.4 million at December 31, 2007, however, as a percentage to total loans outstanding, decreased from 0.33% at December 31, 2006 to 0.22% at December 31, 2007. Loan growth for the year ended December 31, 2007 (excluding the loans acquired through the acquisition of The Bank of Richmond) was $359.8 million as compared with $327.9 million for the year ended December 31, 2006. Impaired loans increased from $4.1 million at December 31, 2006 to $15.2 million at December 31, 2007, resulting in an approximate $682,500 increase in the allowance. At December 31, 2007 and December 31, 2006, respectively, the allowance for loan losses was $15.3 million and $9.4 million, representing 1.01% and 0.95%, respectively, of loans outstanding at the end of each period. Other than the nonaccrual loans listed under the caption "Asset Quality," the Company's loan portfolio continues to perform very well.

Non-Interest Income. Non-interest income aggregated $17.8 million for the year ended December 31, 2007 as compared with $9.3 million for the year ended December 31, 2007, an increase of $8.5 million or 91.6%. Both years were affected by the fluctuations in the fair value and net cash settlements of the economic hedge. Non-interest income included a gain and net cash settlements of the economic hedge of $584,000 for the year ended December 31, 2007; and a loss and net cash settlements of the economic hedge of $1.9 million for the year ended December 31, 2006. The change in fair value was primarily as a result of fluctuations (both favorable and unfavorable) in LIBOR swap interest rate and market conditions during both years. The Company terminated its position in the economic hedge during the third quarter of 2007, and received a termination fee of $115,000 that was included in the above gain for 2007. Revenues from the Company's non-banking activities over the past 12 months have continued to increase. Since inception, the Company has actively pursued additional non-interest income sources outside of traditional banking operations, including income from insurance, mortgage, brokerage operations and title insurance. Revenue from Gateway's insurance operations increased $2.4 million or 81.9% to $5.2 million for the year ended December 31, 2007 as compared with the prior year. The increase in insurance revenues was due primarily to the acquisition of two agencies in Virginia in the fourth quarter of 2006 and a title insurance company during the first quarter of 2007, as well as, internal growth from cross-selling bank customers and building our customer base as our bank franchise has grown. Revenue from the mortgage subsidiary increased $1.4 million or 91.2% in 2007 to $3.0 million over the prior year. The increase in mortgage revenue is attributable to having a full year of operations in 2007 as compared with 2006 in which Gateway Bank Mortgage, Inc. only commenced operations in June. Mortgage revenues in the fourth quarter of the current year decreased 15.4% from the fourth quarter of the prior year attributed primarily to the nationwide issues that affected the mortgage industry during the last half of 2007. Although Gateway Bank Mortgage, Inc. essentially does no sub-prime lending, the limited access to the secondary markets had a negative effect on selling mortgages into the secondary markets, thus slowing revenues during the latter part of the year.

Service charges on deposit accounts increased $644,000 or 19.6% for the year ended December 31, 2007, as compared with the prior year as a result of the Company's growth in transaction deposit accounts from period to period from its expanding financial center network.

Other income increased $945,000 million for the year ended December 31, 2007 as compared with the prior year primarily as a result of the gain in the fair value of its trust preferred debt securities of $960,000 during 2007. The Company elected the fair value option for certain of its trust preferred securities effective January 1 of this year, to hedge its short-term trading investment portfolio. As a result of the unusual credit conditions the financial industry faced during the last half of the year, the credit spreads on these debt securities widened significantly resulting in the gain. It would not be anticipated that the Company would experience a market value gain of this magnitude in the future, and in all likelihood would show a market value loss if credit market conditions become more normalized.

As a result of Gateway's continuous efforts to introduce new products and services in order to better service its customers as well as enhance the overall diversification of its revenue base, non-interest income as a percent of total revenue was 26.6% for the year ended December 31, 2007 as compared with 20.0% for the prior year. Proforma non-interest income (non-interest income excluding the effects of the economic hedge on both periods discussed above) as a percent of total revenue was 25.9% for 2007 as compared with 23.7% for the prior year. Due to the volatility and lack of comparability caused by the economic hedge management believes presentation of an unadjusted non-GAAP pro-forma non-interest income and related percent to the revenues provides useful information to investors.

Non-Interest Expenses. Non-interest expenses aggregated $44.9 million for the year ended December 31, 2007, an increase of $10.0 million or 28.5% over the $34.9 million reported for the prior year. Substantially all of this increase resulted from the Bank's growth and franchise development throughout all of 2006 in which the Bank opened six de novo financial centers, built a state of the art operations center, opened a private banking center, launched a new mortgage subsidiary and made two insurance agency acquisitions; and the opening of three de novo financial centers during the last half of 2007. Additionally, the acquisition of The Bank of Richmond added $2.4

million of non-interest expense during the last seven months of 2007. The acquisition and the significant expansion over the past two years resulted in personnel costs increasing by $7.7 million, or 44.5% to $25.0 million for the year ended December 31, 2007 from $17.3 million for prior year. During the past year the Company had 93 new hires (of which 40 were related to The Bank of Richmond), while the costs of occupancy and equipment costs increased by $1.4 million, or 20.2% to $8.3 million from $6.9 million for the prior year. Other expenses increased $549,000 or 6.0% for the year ended December 31, 2007 as compared with the prior year. The increase was related to approximately $690,000 in higher FDIC premiums that resulted from the FDIC increasing insurance premiums effective January 1 of this year, $204,000 higher franchise taxes that has resulted from the increase in our financial centers in Virginia, and $160,000 higher intangibles amortization that has resulted from acquisitions since the third quarter of last year; offset by lower promotion and consultant expenses.

Provision for Income Taxes. The Company's effective tax rate was approximately 35.2% and 33.3% for the years ended December 31, 2007 and 2006, respectively. The reason that the effective rate was lower for the year ended December 31, 2006 was due to the effect tax-exempt income from municipal securities and BOLI had on lower pre-tax income for that year. As a result of the Company's sustained pattern of profitability we expect our tax rate to remain near the level incurred for the current year. Deferred tax assets have increased primarily due to increases in our loan loss provision.

RESULTS OF OPERATIONS
Years Ended December 31, 2006 and 2005

Overview. The Company reported net income of $5.3 million or $.47 per diluted share for the year ended December 31, 2006, as compared with net income of $3.9 million or $.46 per diluted share for 2005, an increase of $1.3 million or 33.8% in net income, and an increase of $.01 or 2.1% in net income per diluted share. The results from operations were negatively affected during the year by the change in fair value of its interest rate swap that was entered into in December 2005 to hedge the interest rate of its variable loan portfolio. The change in the fair value of this economic hedge reduced non-interest income by $1.2 million, and in total the loss and net cash settlement on the economic hedge was $1.9 million for the year. This loss (net of taxes using a 37.5 % blended rate) reduced net income by $1.2 million or $0.11 per diluted share. The market value of the interest rate swap can be volatile from quarter to quarter, and thus can affect net income positively or negatively depending on interest rate conditions and other factors.

The Company's primary focus continues to be on growth and development of its financial center network and subsidiary operations, sacrificing some profitability in the near term. The Bank opened our first financial center in Raleigh, North Carolina in January 2006 and Norfolk, Virginia in February 2006. In March 2006 the Bank opened another financial center in Virginia Beach, Virginia and opened a newly constructed financial center in Kitty Hawk, North Carolina in April 2006. In addition, we opened two financial centers in August, one in Chesapeake and Virginia Beach adding to our presence in those markets. These new locations increased the number of full-service financial centers to twenty four. The Company has incurred additional non-interest expenses both as a result of growth from period to period, and also as a result of staff additions and other costs incurred as a result of the financial center expansion during 2006. In 2004 interest rates obtained at or near forty year historical lows and steadily rose until June 2006. During 2006, Wall Street Journal Prime increased from 7.25% at December 31, 2005 to 8.25% at the end of June and has remained at 8.25% through December 31, 2006. The Company's interest rate spread has increased primarily due to the Bank's management of the interest rates on its loan and deposit portfolios while maintaining an upward growth trend.

Net Interest Income. Net interest income increased to $37.0 million for the year ended December 31, 2006, a $13.7 million or 58.8% increase from the $23.3 million earned during 2005. Total interest income benefited from growth in the level of average earning assets during the year. Asset growth combined with higher asset yields caused by the increase in market interest rates during periods reported contributed to this rise in income. Average total interest-earning assets increased $345.7 million, or 56.6%, for 2006 as compared to 2005, while the average yield increased by 115 basis points from 6.49% to 7.64%. Average total interest-bearing liabilities increased by $304.5 million, or 56.7% for 2006 as compared to 2005, while the average cost of interest-bearing liabilities increased by 124 basis points from 3.05% to 4.29%. Our cost of funds increased at a higher pace than our yield on interest-earning assets as a result of deposits steadily repricing at higher rates throughout the entire year, while the yield on our loan and investment portfolio has remained relatively flat for the last half of 2006 since the last increase in interest rates occurred in June 2006. This resulted in a 9 basis point decrease in interest rate spread. However, despite the decrease in interest rate spread, because we were able increase our interest earning assets by $41.2 million more than our interest bearing liabilities (primarily as a result of $21.0 million increase in average demand deposit accounts), our interest rate margin improved during 2006 by 6 basis points. For the year ended December 31, 2006, the net interest rate spread was 3.35%

and the net interest margin was 3.87%. For the year ended December 31, 2005, the net interest spread was 3.44% and the net interest margin was 3.81%.

Provision for Loan Losses. The Company recorded a $3.4 million provision for loan losses in 2006, representing an increase of $1.2 million from the $2.2 million provision made in 2005. Provisions for loan losses are charged to income to bring the allowance for loan losses to a level deemed appropriate by Management. In evaluating the allowance for loan losses, Management considers factors that include growth, composition and industry diversification of the portfolio, historical loan loss experience, current delinquency levels, adverse situations that may affect a borrower's ability to repay, estimated value of any underlying collateral, prevailing economic conditions, and other relevant factors. In both 2006 and 2005 the provision for loan losses was made principally in response to growth in loans, as total loans outstanding increased by $327.9 million in 2006 and by $284.7 million in 2005. Additionally, the 2006 provision was also increased as a result of the increase in impaired loans. At December 31, the allowance for loan losses was $9.4 million for 2006 and $6.3 million for 2005, representing .95% and .94%, respectively, of loans outstanding.

Non-Interest Income. Non-interest income totaled $9.3 million for the year ended December 31, 2006 as compared with $8.1 million for 2006, an increase of $1.2 million, or 14.9%. Since inception, the Company has actively pursued additional non-interest income sources outside of traditional banking operations, including income from insurance, mortgage banking, and brokerage networking operations. Non-interest income was negatively affected in 2006 by the loss and net cash settlement on economic hedge of $1.9 million. Of this loss, $1.2 million was related to the drop in fair value of the economic hedge that resulted from the rise in rates primarily during the first half of 2006. The fair value of the economic hedge can be volatile from quarter to quarter and thus effect non-interest income either positively or negatively depending on interest rate conditions and other factors. Excluding the effect of the economic hedge, non-interest income was $11.2 million which represented a $3.1 million or 38.7% increase during 2005.

The 2006 increases were broad based and include $986,000 in service charges on deposit accounts, $495,000 in income from insurance operations, $88,000 in income from brokerage operations, $185,000 from bank owned life insurance, $748,000 from mortgage operations, $560,000 from gain on the sale of securities and $396,000 from other service fee income. The increase in service charges was a direct result of the increase in the number of deposit accounts opened during 2006 that came from the financial center expansion and Haberfeld High Performance Checking program. The increase in insurance operations resulted also from the franchise expansion, growth in lines of business, and the two insurance company acquisitions made in the fourth quarter of 2006. The increase in brokerage revenues resulted from expanding our brokerage services into Virginia during the first quarter with the hiring of an experienced broker in Virginia Beach. The increase in income from bank owned life insurance was the result of purchasing an additional $7.0 million of bank owned life insurance during the third quarter of 2006. During mid 2006 the bank dissolved its 49% ownership of Gateway First Mortgage, LLC ("Gateway First") which provided mortgage banking services to the Bank and to other lenders and replaced it with our wholly owned mortgage subsidiary, Gateway Bank Mortgage, Inc., which accounted for the increase in mortgage revenues in 2006 as compared with the prior year.

Non-Interest Expenses. Non-interest expenses totaled $35.0 million for the year ended December 31, 2006, an increase of $11.7 million or 50.3% over the $23.3 million reported for 2005. In comparison, total assets averaged $1.0 billion for 2006, an increase of 53.7% over average total assets of $679.0 million for the year ended December 31, 2005. Substantially all of the increase in non-interest expenses resulted from the Company's growth and franchise expansion, and reflects the additional expenses in the current year associated with the opening of six new financial centers, increasing the number of full-service banking locations to twenty four; a private banking center, launching a new mortgage subsidiary, opening a new state of the art operations center, starting two new loan production offices, and making two insurance agency acquisitions. Eighteen of the twenty four financial centers were fully operational throughout 2006 and sixteen of the eighteen financial centers were fully operational throughout all of 2005. As a result of such expansion, personnel costs increased by $5.7 million, or 49.2%, the costs of occupancy, data processing and equipment costs increased by $3.0 million or 53.9%, and other non-interest expenses increased by $3.0 million or 49.1%. The increase in other expense included $1.03 million of expenses related to the Haberfeld High Performance Checking account program in 2006 (there were none of these expenses in 2005), and an increase of $237,000 related to other promotional and advertising costs, increased franchise taxes related to Virginia financial center expansion of $500,000, increased consulting and professional costs of $318,000, and increased travel and business development expenses of $340,000. Despite these higher expenses as a percentage of average total assets, total non-interest expenses decreased to 3.35% for 2006 from 3.43% for 2005.

Income Taxes. Income tax expense was $2.6 million for 2006 as compared with $2.0 million for 2005. The Company's effective tax rate for both tax years was approximately 33.3%. As a result of the Company's sustained pattern of profitability we expect our tax rate to remain near this level in 2007. Deferred taxes increased primarily due to increases in our allowance for loan losses and the unrealized loss related to our economic hedge.

LIQUIDITY AND CAPITAL RESOURCES

The Company's sources of funds are customer deposits, cash and demand balances due from other banks, interest-earning deposits in other banks and trading and investment securities available for sale. These funds, together with loan repayments, are used to make loans and to fund continuing operations. In addition, at December 31, 2007, the Bank had credit availability with the Federal Home Loan Bank of Atlanta ("FHLB") of approximately $195.0 million, with $174.0 million outstanding secured by commercial loans and investment securities; federal funds lines of credit with six other financial institutions in the aggregate amount of $106.5 million from which $28 million was borrowed at December 31, 2007; and a line of credit with a bank of $20.0 million from which $4.0 million was borrowed at December 31, 2007. The Company also utilizes the wholesale brokered CD market to fund liquidity on an as needed basis.

Total deposits were $1.4 billion and $923.7 million at December 31, 2007 and 2006, respectively. As a result of the Company's loan demand exceeding the rate at which core deposits have been built, the Company has relied significantly on time deposits as a source of funds. Certificates of deposit are the only deposit accounts that have stated maturity dates. Such deposits are generally considered to be rate sensitive. At December 31, 2007, time deposits represented 62.6% of the Company's total deposits, up from 59.2% of total deposits at December 31, 2006. Certificates of deposit of $100,000 or more represented 19.3% and 22.2%, respectively, of the Bank's total deposits at December 31, 2007 and 2006. At December 31, 2007, the Company had $225.9 million in brokered time deposits, representing 16.0% of total deposits at that date, up from 10.3% of total deposits at December 31, 2006. The bank has primarily used brokered deposits to fund its loan production offices and private banking center. While the Company will need to pay competitive rates to retain these deposits at their maturities, there are other subjective factors that will determine their continued retention. Based upon prior experience, the Company anticipates that a substantial portion of outstanding certificates of deposit will renew upon maturity.

Management anticipates that the Company will rely primarily upon customer deposits, loan repayments, current earnings, brokered deposits, and as necessary, additional borrowings, to provide liquidity, and will use funds thus generated to make loans and to purchase securities, primarily securities issued by the federal government and its agencies, corporate securities, and mortgage-backed securities.

At December 31, 2007 and 2006, the Company's tangible equity to asset ratio was 6.07% and 8.04%, respectively. All capital ratios place the Bank in excess of the minimum required to be deemed a well-capitalized bank by regulatory measures. The regulatory capital position of both the Company and the Bank was enhanced during December 2007 with the issuance of $23.2 million in perpetual non-cumulative preferred stock and $25.7 million of trust preferred securities in May 2007 that qualify, subject to certain limitations, as Tier 1 capital. The Company's Tier 1 capital ratio at December 31, 2007 and 2006 was 10.43% and 12.11%, respectively.

CAPITAL RATIOS

The Bank is subject to minimum capital requirements. See "SUPERVISION AND REGULATION." As the following table indicates, at December 31, 2007, the Bank exceeded regulatory capital requirements.

	At December 31, 2007		
	Actual Ratio	Minimum Requirement	Well-Capitalized Requirement
Total risk-based capital ratio	11.19%	8.0%	10.0%
Tier 1 risk-based capital ratio	10.24%	4.0%	6.0%
Leverage ratio	9.46%	4.0%	5.0%

Management expects that the Bank will remain "well-capitalized" for regulatory purposes, although there can be no assurance that additional capital will not be required in the near future due to greater-than-expected growth, or otherwise.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

In the normal course of business there are various outstanding contractual obligations of the Company that will require future cash outflows. In addition, there are commitments and contingent liabilities, such as commitments to extend credit that may or may not require future cash outflows. The following table reflects contractual obligations of the Company outstanding as of December 31, 2007.

	Payments Due by Period				
Contractual Obligations	Total	On Demand Or Within 1 Year	2-3 Years	4-5 Years	After 5 Years
			(In thousands)		
Federal funds purchased	$ 28,000	$ 28,000	$ —	$ —	$ —
FHLB advances	174,000	5,000	6,500	145,000	17,500
Reverse purchase agreements	20,000	—	—	10,000	10,000
Junior subordinated debentures	56,102	—	—	—	56,102
Line of credit with a bank	4,000	—	4,000	—	—
Lease obligations	19,010	1,574	2,737	2,349	12,350
Deposits	1,408,919	1,349,704	42,826	16,368	21
Total contractual cash obligations	$1,710,031	$ 1,384,277	$ 56,063	$173,717	$ 95,973

The following table reflects other commitments of the company outstanding as of December 31, 2007.

	Amount of Commitment Expiration Per Period				
Other Commitments	Total Amounts Committed	Within 1 Year	2-3 Years	4-5 Years	After 5 Years
			(In thousands)		
Undisbursed home equity credit lines	$ 69,789	$ 69,789	$ —	$ —	$ —
Other commitments and credit lines	269,640	269,640	—	—	—
Undisbursed portion of construction loans	122,475	122,475	—	—	—
Standby letters of credit	19,411	19,411	—	—	—
Commitments to originate mortgage Loans, fixed and variable rate	12,181	12,181	—	—	—
Total other commitments	$ 493,496	$493,496	$ —	$ —	$ —

In the normal course of business, the Company may enter into purchase agreements for goods or services. In management's opinion, the dollar amount of such agreements at December 31, 2007 is not material and has not been included in the above table.

ASSET/LIABILITY MANAGEMENT

The Company's results of operations depend substantially on its net interest income. Like most financial institutions, the Bank's interest income and cost of funds are affected by general economic conditions and by competition in the market place. The purpose of asset/liability management is to provide stable net interest income growth by protecting the Company's earnings from undue interest rate risk, which arises from volatile interest rates and changes in the balance sheet mix, and by managing the risk/return relationships between liquidity, interest rate risk, market risk, and capital adequacy. The Company maintains, and has complied with, a Board approved asset/liability management policy that provides guidelines for controlling exposure to interest rate risk by utilizing the following ratios and trend analysis: liquidity, equity, volatile liability dependence, portfolio maturities, maturing assets and maturing liabilities. The Company's policy is to control the exposure of its earnings to changing interest rates by generally endeavoring to maintain a position within a narrow range around an "earnings neutral position," which is defined as the mix of assets and liabilities that generate a net interest margin that is least affected by interest rate changes.

When suitable lending opportunities are not sufficient to utilize available funds, the Company has generally invested such funds in securities, primarily U.S. Treasury securities, securities issued by governmental agencies, mortgage-backed securities and corporate obligations. The securities portfolio contributes to the Company's profits and plays an important part in the overall interest rate management. However, management of the securities portfolio alone cannot balance overall interest rate risk. The securities portfolio must be used in combination with other asset/liability techniques to actively manage the balance sheet. The primary objectives in the overall management of the securities portfolio are safety, liquidity, yield, asset/liability management (interest rate risk), and investing in securities that can be pledged for public deposits.

In reviewing the needs of the Company with regard to proper management of its asset/liability program, the Company's management estimates its future needs, taking into consideration historical periods of high loan demand and low deposit balances, estimated loan and deposit increases (due to increased demand through marketing), and forecasted interest rate changes. A number of measures are used to monitor and manage interest rate risk, including income simulations and interest sensitivity (gap) analyses. An income simulation model is the primary tool used to assess the direction and magnitude of changes in net interest income resulting from changes in interest rates. Key assumptions in the model include prepayment speeds on mortgage-related assets, cash flows and maturities of other investment securities, loan and deposit volumes and pricing. These assumptions are inherently uncertain and, as a result, the model cannot precisely estimate net interest income or precisely predict the impact of higher or lower interest rates on net interest income. Actual results will differ from simulated results due to timing, magnitude and frequency of interest rate changes and changes in market conditions and management strategies, among other factors.

Based on the results of the income simulation model as of November 30, 2007, the Company would expect an increase in net interest income of $1.6 million if interest rates increase from rates as of December 31, 2007 by 200 basis points and a decrease in net interest income of $6.0 million if interest rates decrease from rates as of December 31, 2007 by 200 basis points.

The analysis of an institution's interest rate gap (the difference between the repricing of interest-earning assets and interest-bearing liabilities during a given period of time) is another standard tool for the measurement of the exposure to interest rate risk. The Company believes that because interest rate gap analysis does not address all factors that can affect earnings performance, it should be used in conjunction with other methods of evaluating interest rate risk.

The following table sets forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2007 which are projected to reprice or mature in each of the future time periods shown. Except as stated below, the amounts of assets and liabilities shown which reprice or mature within a particular period were determined in accordance with the contractual terms of the assets or liabilities. Loans with adjustable rates are shown as being due at the end of the next upcoming adjustment period. Money market deposit accounts and negotiable order of withdrawal or other transaction accounts are assumed to be subject to immediate repricing and depositor availability and have been placed in the shortest period. In making the gap computations, none of the assumptions sometimes made regarding prepayment rates and deposit decay rates have been used for any interest-earning assets or interest-bearing liabilities. In addition, the table does not reflect scheduled principal payments which will be received throughout the lives of the loans. The interest rate sensitivity of the Company's assets and liabilities illustrated in the following table would vary substantially if different assumptions were used or if actual experience differs from that indicated by such assumptions.

	Terms to Repricing at December 31, 2007				
	3 Months or Less	Over 3 Months to 12 Months	Total Within 12 Months	Over 12 Months	Total
			(Dollars in thousands)		
Interest-earning assets:					
Loans	$911,465	$ 93,632	$1,005,097	$517,304	$1,522,401
Interest-earning deposits	1,092	—	1,092	—	1,092
Investment securities available for sale	5,720	492	6,212	120,538	126,750
Trading securities	23,011	—	23,011	—	23,011
FHLB/FRB stock	15,660	—	15,660	—	15,660
Total interest-earning assets	$956,948	$ 94,124	$1,051,072	$637,842	$1,688,914
Percentage of total interest-earning assets	56.66%	5.57%	62.23%	37.77%	100.00%
Cumulative percentage to total interest- earning assets	56.66%	62.23%	62.23%	100.00%	100.00%
Interest-bearing liabilities:					
Deposits:					
Savings, NOW and money market	$402,523	$ —	$ 402,523	$ —	$ 402,523
Time	274,389	548,907	823,296	59,215	882,511
Borrowings	88,102	5,000	93,102	189,000	282,102
Total interest-bearing liabilities	$765,014	$ 553,907	$1,318,921	$248,215	$1,567,136
Percentage of total interest-bearing liabilities	48.82%	35.34%	84.16%	15.84%	100.00%
Cumulative percentage of total interest- bearing liabilities	48.82%	84.16%	84.16%	100.00%	100.00%
Interest sensitivity gap	$191,934	$ (459,783)	$ (267,849)	$389,627	$ 121,778
Cumulative interest sensitivity gap	$191,934	$ (267,849)	$ (267,849)	$121,778	$ 121,778
Cumulative interest sensitivity gap as a percentage of total interest-earning assets	11.36%	(15.86)%	(15.86)%	7.21%	7.21%
Cumulative ratio of interest-sensitive assets to interest-sensitive liabilities	125.09%	79.69%	79.69%	107.77%	107.77%

The table illustrates that if assets and liabilities reprice in the time intervals indicated in the table, the Company is asset sensitive in the very short-term (three months or less), becomes liability sensitive between three and twelve months, and then becomes asset sensitive again over twelve months. As stated above, certain shortcomings are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market interest rates. For instance, while the table is based on the assumption that interest-bearing demand accounts, money market accounts and savings accounts are immediately sensitive to movements in rates, the Company expects that in a changing rate environment the amount of the adjustment in interest rates for such accounts would be less than the adjustment in categories of assets which are considered to be immediately sensitive. Additionally, certain assets have features which restrict changes in the interest rates of such assets both on a short-term basis and over the lives of such assets. Further, in the event of a change in market interest rates, prepayment and early withdrawal levels could deviate significantly from those assumed in calculating the tables. Finally, the ability of many borrowers to service their adjustable-rate debt may decrease in the event of an increase in market interest rates. Due to these shortcomings, the Company places primary emphasis on its income simulation model when managing its exposure to changes in interest rates.

CRITICAL ACCOUNTING POLICIES

The preparation of the Company's audited consolidated financial statements and the information included in management's discussion and analysis is governed by policies that are based on accounting principles generally accepted in the United States of America and general practices within the banking industry. Among the more

significant policies are those that govern accounting for loans and allowance for loan losses, stock based compensation, derivatives and goodwill. These policies are discussed in Note B of the "Notes To Consolidated Financial Statements" included in this Annual Report.

A critical accounting policy is one that is both very important to the portrayal of the Company's financial condition and results, and requires a difficult, subjective or complex judgment by management. What makes these judgments difficult, subjective and/or complex is the need to make estimates about the effects of matters that are inherently uncertain. Estimates and judgments are integral to our accounting for certain items, and those estimates and judgments affect the reported amounts of assets, liabilities, revenues, expenses and related disclosure of contingent assets and liabilities. The Company periodically evaluates its estimates, including those related to the allowance for loan losses, goodwill, intangible assets, and stock based compensation. While we base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, actual results may differ from these estimates under different assumptions or conditions. Further information regarding the accounting policies that we consider to be critical is provided below.

Allowance for loan losses. The Company's most significant critical accounting policy is the determination of its allowance for loan losses. The allowance for loan losses reflects the estimated losses that will result from the inability of our customers to make required payments. The allowance for loan losses results from management's evaluation of the risk characteristics of the loan portfolio under current economic conditions and considers such factors as the financial condition of the borrower, fair market value of collateral and other items that, in our opinion, deserve current recognition in estimating possible credit losses. Our evaluation process is based on historical evidence and current trends among delinquencies, defaults and nonperforming assets. Our estimate of the allowance for loan losses does not include the impact of events that might occur in the future.

Management considers the established allowance adequate to absorb losses that relate to loans outstanding at December 31, 2007, although future additions to the allowance may be necessary based on changes in economic conditions and other factors. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan losses. Such agencies may require adjustments to the allowance based on their judgments of information available to them at the time of their examination. If the financial condition of our borrowers were to deteriorate, resulting in an impairment of their ability to make payments, our estimates would be updated, and additional provisions may be required. For further information on the allowance for loan losses, see "Financial Condition" in Management's Discussion and Analysis and Note D of the "Notes to Consolidated Financial Statements" included in this Annual Report.

Goodwill and Other Intangible Assets. Intangible assets include goodwill and other identifiable assets, such as core deposit premiums, resulting from acquisitions. Core deposit premiums are amortized primarily on a straight-line basis over a ten-year life based upon historical studies of core deposits. Intangible assets related to insurance agency acquisitions are amortized over the expected life of the book of business acquired. Goodwill is not amortized but is tested annually for impairment or at any time an event occurs or circumstances change that may trigger a decline in the value of the reporting unit. Examples of such events or circumstances include adverse changes in legal factors, business climate, unanticipated competition, change in regulatory environment or loss of key personnel.

The Company tests for impairment in accordance with SFAS No. 142. Potential impairment of goodwill exists when the carrying amount of a reporting unit exceeds its fair value. The fair value of a reporting unit is computed using one or a combination of the following three methods: income, market value or cost method. The income method uses a discounted cash flow analysis to determine fair value by considering a reporting unit's capital structure and applying a risk-adjusted discount rate to forecast earnings based on a capital asset pricing model. The market value method uses recent transaction analysis or publicly traded comparable analysis for similar assets and liabilities to determine fair value. The cost method assumes the net assets of a recent business combination accounted for under the purchase method of accounting will be recorded at fair value if no event or circumstance has occurred triggering a decline in the value. To the extent a reporting unit's carrying amount exceeds its fair value, an indication exists that the reporting unit's goodwill may be impaired, and a second step of impairment test will be performed. In the second step, the implied fair value of the reporting unit's goodwill, determined by allocating the reporting unit's fair value to all of its assets (recognized and unrecognized) and liabilities as if the reporting unit had been acquired in a business combination at the date of the impairment test. If the implied fair value of reporting unit goodwill is lower than its carrying amount, goodwill is impaired and is written down to its implied fair value. The loss recognized is limited to the carrying amount of goodwill. Once an impairment loss is recognized, future increases in fair value will not result in the reversal of previously recognized losses.

Stock Compensation Plans. Effective January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), "Share-

Based Payment," ("SFAS No. 123R") which was issued by the FASB in December 2004. SFAS No. 123R revises SFAS No. 123 "Accounting for Stock Based Compensation," and supersedes APB No. 25, "Accounting for Stock Issued to Employees," (APB No. 25) and its related interpretations. SFAS No. 123R requires recognition of the cost of employee services received in exchange for an award of equity instruments in the financial statements over the period the employee is required to perform the services in exchange for the award (presumptively the vesting period). SFAS No. 123R also requires measurement of the cost of employee services received in exchange for an award based on the grant-date fair value of the award. SFAS No. 123R also amends SFAS No. 95 "Statement of Cash Flows," to require that excess tax benefits be reported as financing cash inflows flows, rather than as a reduction of taxes paid, which is included within operating cash flows.

The Company adopted SFAS No. 123R using the modified prospective application as permitted under SFAS No. 123R. Accordingly, prior period amounts have not been restated. Under this application, the Company is required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding at the date of adoption.

Prior to the adoption of SFAS No. 123R, the Company used the intrinsic value method as prescribed by APB No. 25 and thus recognized no compensation expense for options granted with exercise prices equal to the fair market value of the Company’s common stock on the date of the grant.

OFF-BALANCE SHEET ARRANGEMENTS

Information about the Company’s off-balance sheet risk exposure is presented in Note K to the accompanying consolidated financial statements. As part of its ongoing business, the Company does not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as special purpose entities (SPEs), which generally are established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of December 31, 2007, except as otherwise disclosed in Note G to the accompanying consolidated financial statements, the Company is not involved in any unconsolidated SPE transactions.

RECENT ACCOUNTING PRONOUNCEMENTS

See Note B to the consolidated financial statements for a full description of recent accounting pronouncements including the respective expected dates of adoption and effects on results of operations and financial condition.

LENDING ACTIVITIES

General. The Company provides to its customers a full range of short- to medium-term commercial and industrial, real estate, agricultural, Small Business Administration guaranteed, Farmers Home Administration guaranteed, mortgage, construction and consumer loans, both secured and unsecured.

The Company’s loan policies and procedures establish the basic guidelines governing its lending operations. Generally, the guidelines address the types of loans that the Company seeks, target markets, underwriting and collateral requirements, terms, interest rate and yield considerations and compliance with laws and regulations. All loans or credit lines are subject to approval procedures and amount limitations. These limitations apply to the borrower’s total outstanding indebtedness to the Company, including the indebtedness of any guarantor. The policies are reviewed and approved at least annually by the Board of Directors of the Company. The Company supplements its own supervision of the loan underwriting and approval process with periodic loan audits by internal loan examiners and outside professionals experienced in loan review work. The Company has focused its portfolio lending activities on typically higher yielding commercial, construction and consumer loans rather than lower yielding 1-4 family mortgages which the Company typically sells in the secondary market. The following table sets forth at the dates indicated the Company’s loan portfolio composition by type of loan:

	At December 31,			
	2007		2006	
	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in thousands)			
Commercial & industrial	$ 263,283	17.3%	$137,658	13.8%
Real estate – construction	604,335	39.7%	381,788	38.4%
Real estate – commercial mortgage	321,806	21.1%	229,752	23.1%
Real estate – 1-4 family mortgage	193,549	12.7%	128,920	13.0%
Consumer	22,133	1.4%	15,347	1.5%
Mortgage loans held for sale	5,624	.4%	15,576	1.6%
Home equity lines of credit	113,191	7.4%	85,882	8.6%
Subtotal	1,523,921	100.0%	994,923	100.0%
Less: Allowance for loan losses	(15,339)		(9,405)	
Unamortized net deferred (fees) costs	(1,520)		(331)	
Net loans	$1,507,062		$985,187	

	At December 31,			
	2005		2004	
	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in thousands)			
Commercial & industrial	$ 75,935	11.4%	$ 69,075	18.0%
Real estate – construction	256,720	38.4%	131,431	34.4%
Real estate – commercial mortgage	155,396	23.3%	90,197	23.6%
Real estate – 1-4 family mortgage	97,215	14.6%	51,768	13.5%
Consumer	12,962	1.9%	10,641	2.8%
Home equity lines of credit	69,246	10.4%	29,350	7.7%
Subtotal	667,474	100.0%	382,462	100.0%
Less: Allowance for loan losses	(6,283)		(4,163)	
Unamortized net deferred (fees) costs	(822)		(506)	
Net loans	$660,369		$377,793	

	At December 31,	
	2003	
	Amount	Percent of Total
	(Dollars in thousands)	
Commercial	$ 52,554	22.7%
Real estate – construction	55,970	24.2%
Real estate – commercial mortgage	68,094	29.3%
Real estate – 1-4 family mortgage	32,191	13.9%
Consumer	10,458	4.5%
Home equity lines of credit	12,615	5.4%
Subtotal	231,882	100.0%
Less: Allowance for loan losses	(2,759)	
Unamortized net deferred (fees) costs	(142)	
Net loans	$228,981	

The following table presents, at December 31, 2007, (i) the aggregate maturities or repricings of loans in the named categories of the Company's loan portfolio and (ii) the aggregate amounts of such loans maturing or repricing after one year by fixed and variable rates:

	Within 1 Year	1-5 Years	After 5 Years	Total
		(Dollars in thousands)		
Real estate — construction	$ 498,226	$ 79,947	$ 26,163	$604,336
Commercial and industrial	173,267	77,902	12,116	263,285
Total	$ 671,493	$157,849	$ 38,279	$867,621
Fixed rate loans				$187,794
Variable rate loans				8,334
				$196,128

Commercial & Industrial Loans. Commercial business lending is a primary focus of the Company's lending activities. At December 31, 2007, the Company's commercial and industrial loan portfolio equaled $263.3 million or 17.3% of total loans, as compared with $137.7 million or 13.8% of total loans at December 31, 2006. Commercial and industrial loans include both secured and unsecured loans for working capital, expansion, and other business purposes. Short-term working capital loans generally are secured by accounts receivable, inventory and/or equipment. The Company also makes term commercial loans secured by equipment and real estate. Lending decisions are based on an evaluation of the financial strength, management and credit history of the borrower, and the quality of the collateral securing the loan. With few exceptions, the Company requires personal guarantees and secondary sources of repayment.

Commercial loans generally provide greater yields and reprice more frequently than other types of loans, such as real estate loans. More frequent repricing means that yields on our commercial loans adjust with changes in interest rates.

Real Estate Loans. Real estate loans are made for purchasing, constructing and refinancing one to four family, five or more family and commercial properties. The Company offers fixed and adjustable rate options. The Company provides customers access to long-term conventional real estate loans through its mortgage subsidiary which makes Federal National Mortgage Association ("FNMA") – conforming loans for the account of third parties.

At December 31, 2007, the Company's residential one to four family loans amounted to $193.5 million or 12.7% of total loans as compared with $128.9 million or 13.0% of total loans at December 31, 2006. The Company's residential mortgage loans are secured by properties located within the Company's market area. Some of the one to four family residential mortgage loans that the Company makes are originated for the account of third parties, either through the Bank or Gateway Bank Mortgage, Inc. Such loans are booked as loans held for resale until the loan is sold. At December 31, 2007 such loans aggregated $5.6 million as compared with $15.6 million at December 31, 2006. The Company receives fees for each such loan originated and/or sold, with such fees included in income from mortgage operations which aggregated $3.0 million for the year ended December 31, 2007 and $1.6 million for the year ended December 31, 2006. The Company anticipates that it will continue to be an active originator of residential loans.

The Company has made, and anticipates continuing to make, commercial real estate loans. Commercial real estate loans equaled $321.8 or 21.1% of total loans at December 31, 2007 and $229.8 million or 23.1% of total loans at December 31, 2006. This lending has involved loans secured principally by commercial buildings for office, storage and warehouse space, and by agricultural properties. Generally in underwriting commercial real estate loans, the Company requires the personal guaranty of borrowers and a demonstrated cash flow capability sufficient to service the debt. Loans secured by commercial real estate may be in greater amount and involve a greater degree of risk than one to four family residential mortgage loans. Payments on such loans are often dependent on successful operation or management of the properties.

The Company originates one to four family residential construction loans for the construction of custom homes (where the home buyer is the borrower) and provides financing to builders and consumers for the construction of pre-sold homes and development of properties. The Company also makes commercial real estate construction loans, generally for owner-occupied properties. Real estate construction, acquisition and development loans amounted to

$604.3 million or 39.7% of total loans at December 31, 2007 and $381.8 million or 38.4% of total loans at December 31, 2006. The Company generally receives a pre-arranged permanent financing commitment from an outside entity prior to financing the construction of pre-sold homes. The Company lends to builders and developers who have demonstrated a favorable record of performance and profitable operations and who are building in markets that management believes it understands and in which it is comfortable with the economic conditions. The Company further endeavors to limit its construction lending risk through adherence to established underwriting procedures. Also, the Company generally requires documentation of all draw requests and utilizes loan officers to inspect the project prior to paying any draw requests from the builder. With few exceptions, the Company requires personal guarantees and secondary sources of repayment on construction loans.

Consumer Loans and Home Equity Lines of Credits. Loans to individuals include automobile loans, boat and recreational vehicle financing, home equity and home improvement loans and miscellaneous secured and unsecured personal loans. Consumer loans generally can carry significantly greater risks than other loans, even if secured, if the collateral consists of rapidly depreciating assets such as automobiles and equipment. Repossessed collateral securing a defaulted consumer loan may not provide an adequate source of repayment of the loan. Consumer loan collections are sensitive to job loss, illness and other personal factors. The Company attempts to manage the risks inherent in consumer lending by following established credit guidelines and underwriting practices designed to minimize risk of loss.

Loan Approvals. The Company's loan policies and procedures establish the basic guidelines governing its lending operations. Generally, the guidelines address the type of loans that the Company seeks, target markets, underwriting and collateral requirements, terms, interest rate and yield considerations and compliance with laws and regulations. All loans or credit lines are subject to approval procedures and amount limitations. These limitations apply to the borrower's total outstanding indebtedness to the Company, including the indebtedness of any guarantor. The policies are reviewed and approved at least annually by the Board of Directors of the Company. The Company supplements its own supervision of the loan underwriting and approval process with periodic loan audits by independent, outside professionals experienced in loan review work.

Commitments and Contingent Liabilities

In the ordinary course of business, the Company enters into various types of transactions that include commitments to extend credit that are not included in loans receivable, net, presented on the Company's consolidated balance sheets. The Company applies the same credit standards to these commitments as it uses in all its lending activities and has included these commitments in its lending risk evaluations. The Company's exposure to credit loss under commitments to extend credit is represented by the amount of these commitments. See "NOTES TO CONSOLIDATED FINANCIAL STATEMENTS."

Asset Quality

The Company considers asset quality to be of primary importance, and employs a formal internal loan review process to ensure adherence to the Lending Policy as approved by the Board of Directors. It is the responsibility of each lending officer to assign an appropriate risk grade to every loan originated. Credit Administration, through the loan review process, validates the accuracy of the initial risk grade assessment. In addition, as a given loan's credit quality improves or deteriorates, it is Credit Administration's responsibility to change the borrower's risk grade accordingly. The function of determining the allowance for loan losses is fundamentally driven by the risk grade system. In determining the allowance for loan losses and any resulting provision to be charged against earnings, particular emphasis is placed on the results of the loan review process. Consideration is also given to historical loan loss experience, the value and adequacy of collateral, economic conditions in the Company's market area and other factors. For loans determined to be impaired, the allowance is based on discounted cash flows using the loan's initial effective interest rate or the fair value of the collateral for certain collateral dependent loans. This evaluation is inherently subjective as it requires material estimates, including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. The allowance for loan losses represents management's estimate of the appropriate level of reserve to provide for probable losses inherent in the loan portfolio.

The Company's policy regarding past due loans normally requires a prompt charge-off to the allowance for loan losses following timely collection efforts and a thorough review. Further efforts are then pursued through various means available. Loans carried in a non-accrual status are generally collateralized and probable losses are considered in the determination of the allowance for loan losses.

Nonperforming Assets

The table sets forth, for the period indicated, information with respect to the Company's nonaccrual loans, restructured loans, total nonperforming loans (nonaccrual loans plus restructured loans), and total nonperforming assets.

	At December 31,				
	2007	2006	2005	2004	2003
	(Dollars in thousands)				
Nonaccrual loans	$ 3,407	$ 3,269	$ 204	$ 490	$ 1,210
Restructured loans	—	—	—	—	—
Total nonperforming loans	3,407	3,269	204	490	1,210
Real estate owned	482	—	—	—	—
Total nonperforming assets	$ 3,889	$ 3,269	$ 204	$ 490	$ 1,210
Accruing loans past due 90 days or more	$ —	$ —	$ —	$ —	$ —
Allowance for loan losses	15,339	9,405	6,283	4,163	2,759
Nonperforming loans to period end loans	.22%	0.33%	0.03%	0.13%	0.52%
Allowance for loan losses to period end loans	1.01%	0.95%	0.94%	1.09%	1.19%
Allowance for loan losses to nonperforming loans	450.22%	287.70%	3,079.90%	849.59%	228.02%
Nonperforming assets to total assets	.21%	0.27%	0.02%	0.09%	0.38%

Our consolidated financial statements are prepared on the accrual basis of accounting, including the recognition of interest income on loans, unless we place a loan on nonaccrual basis. We account for loans on a nonaccrual basis when we have serious doubts about the collectability of principal or interest. Generally, our policy is to place a loan on nonaccrual status when the loan becomes past due 90 days. We also place loans on nonaccrual status in cases where we are uncertain whether the borrower can satisfy the contractual terms of the loan agreement. Amounts received on nonaccrual loans generally are applied first to principal and then to interest only after all principal has been collected. Restructured loans are those for which concessions, including the reduction of interest rates below a rate otherwise available to that borrower or the deferral of interest or principal, have been granted due to the borrower's weakened financial condition. We accrue interest on restructured loans at the restructured rates when we anticipate that no loss of original principal will occur. Potential problem loans are loans which are currently performing and are not included in nonaccrual or restructured loans above, but about which we have serious doubts as to the borrower's ability to comply with present repayment terms. These loans are likely to be included later in nonaccrual, past due or restructured loans, so they are considered by management in assessing the adequacy of our allowance for loan losses. At December 31, 2007, we had $11.8 million of potential problem loans. Real estate owned consists of foreclosed, repossessed and idled properties. At December 31, 2007 the Company had $482,000 of real estate owned.

Analysis of Allowance for Loan Losses

Our allowance for loan losses is established through charges to earnings in the form of a provision for loan losses. We increase our allowance for loan losses by provisions charged to operations and by recoveries of amounts previously charged off, and we reduce our allowance by loans charged off. We evaluate the adequacy of the allowance at least quarterly. In addition, on a monthly basis our board of directors reviews our loan portfolio, conducts an evaluation of our credit quality and reviews our computation of the loan loss provision, recommending changes as may be required. In evaluating the adequacy of the allowance, we consider the growth, composition and industry diversification of the portfolio, historical loan loss experience, current delinquency levels, adverse situations that may affect a borrower's ability to repay, estimated value of any underlying collateral, prevailing economic conditions and other relevant factors deriving from our limited history of operations. Because we have a limited history of our own, we also consider the loss experience and allowance levels of other similar banks and the historical experience encountered by our management and senior lending officers prior to joining us. In addition, regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan

losses and may require us to make adjustments to the allowance based upon judgments different from those of our management.

We use our risk grading program, as described under "Asset Quality," to facilitate our evaluation of probable inherent loan losses and the adequacy of the allowance for loan losses. In this program, risk grades are initially assigned by loan officers and reviewed by Credit Administration, and tested as part of the periodic loan audit by independent, outside professionals experienced in loan review work. The testing program includes an evaluation of a sample of new loans, large loans, loans that are identified as having potential credit weaknesses, loans past due 90 days or more, and nonaccrual loans. We strive to maintain our loan portfolio in accordance with conservative loan underwriting policies that result in loans specifically tailored to the needs of our market area. Every effort is made to identify and minimize the credit risks associated with such lending strategies. We have no foreign loans and we do not engage in significant lease financing or highly leveraged transactions.

We follow a loan review program designed to evaluate the credit risk in our loan portfolio. Through this loan review process, we maintain an internally classified watch list that helps management assess the overall quality of the loan portfolio and the adequacy of the allowance for loan losses. In establishing the appropriate classification for specific assets, management considers, among other factors, the estimated value of the underlying collateral, the borrower's ability to repay, the borrower's payment history and the current delinquent status. As a result of this process, certain loans are categorized as substandard, doubtful or loss. Reserves are allocated based on management's judgment and historical experience.

Loans classified as "substandard" are those loans with clear and defined weaknesses such as unfavorable financial ratios, uncertain repayment sources or poor financial condition that may jeopardize the liquidation of the debt. They are characterized by the distinct possibility that we will sustain some losses if the deficiencies are not corrected. Loans classified as "doubtful" are those loans that have characteristics similar to substandard loans but with an increased risk that collection or liquidation in full is highly questionable and improbable. Loans classified as "loss" are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value but rather it is not practical or desirable to defer writing off this asset even though partial recovery may be achieved in the future. As a practical matter, when loans are identified as loss, the estimated loss is calculated and charged off against the allowance for loan losses. In addition to the above classification categories, we also categorize loans based upon risk grade and loan type, estimating an allowance allocation based upon each homogenous loan pool.

Growth in loans outstanding has, throughout our history, been the primary reason for increases in our allowance for loan losses and the resultant provisions for loan losses necessary to provide for those increases. This growth has been spread among our major loan categories. Since December 31, 2005 our loan portfolio has more than doubled, growing $855.7 million. Therefore, over half of our loan portfolio is unseasoned and less than two years old. We have maintained excellent asset quality through-out our history. For all fiscal years through 2007, our net loan charge-offs in each year were no more than 0.15% of average loans outstanding, and were 0.09% for the year ended December 31, 2007. However, because a substantial portion of our portfolio is unseasoned, even with the sustained trend of low loss experience, based upon all the qualitative factors as discussed above and our assessment of probable loss, we have set our allowance for loan losses at December 31, 2007 at $15.3 million, representing 1.01% of total loans outstanding, which is consistent with .95% at December 31, 2006.

The allowance for loan losses represents management's estimate of an amount adequate to provide for known and inherent losses in the loan portfolio in the normal course of business. We make specific allowances that are allocated to certain individual loans and pools of loans based on risk characteristics, as discussed below. A portion of allowance assigned to each pool of loans contains estimated components based on historical data, economic trends, peer group analysis, past due analysis, interest rate trends, unemployment trends, inflation rates and the unseasoned segment of the loan portfolio. A portion of the allowance is intended to reserve for the inherent risk in the portfolio and the intrinsic inaccuracies associated with the estimation of the allowance for loan losses and its allocation to specific loan categories. While management believes that it uses the best information available to establish the allowance for loan losses, future adjustments to the allowance may be necessary and results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making the determinations. Furthermore, while we believe we have established the allowance for loan losses in conformity with generally accepted accounting principles (SFAS 5 and SFAS 114) in conjunction with guidance issued by the Securities Exchange Commission (i.e. SAB 102), there can be no assurance that regulators, in reviewing our portfolio, will not require an increase or decrease in our allowance for loan losses. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that increases will not be necessary should the quality of any loans deteriorate as a result

of the factors discussed herein. Any material increase in the allowance for loan losses may adversely affect our financial condition and results of operations.

The following table shows the allocation of the allowance for loan losses at the dates indicated. The allocation is based on an evaluation of defined loan problems, historical ratios of loan losses and other factors that may affect future loan losses in the categories of loans shown.

	At December 31,			
	2007		2006	
	Amount	% of Total Loans (1)	Amount	% of Total Loans (1)
	(Dollars in thousands)			
Balance applicable to:				
Commercial & industrial	$ 3,105	17.28%	$ 1,852	11.37%
Real estate – construction	5,886	39.66%	3,377	38.46%
Real estate – commercial mortgage	3,102	21.12%	2,083	23.28%
Real estate – 1-4 family mortgage	1,550	13.06%	1,087	14.56%
Consumer	301	1.45%	192	1.95%
Home equity lines of credit	1,395	7.43%	814	10.38%
Total	$ 15,339	100.0%	$ 9,405	100.0%

	At December 31,			
	2005		2004	
	Amount	% of Total Loans (1)	Amount	% of Total Loans (1)
	(Dollars in thousands)			
Balance applicable to:				
Commercial & industrial	$ 833	11.4%	$ 667	18.0%
Real estate – construction	2,464	38.4%	1,577	34.4%
Real estate – mortgage	2,277	37.9%	1,477	37.1%
Consumer	169	1.9%	128	2.8%
Home equity lines of credit	540	10.4%	294	7.7%
Unallocated	—	—	20	—
Total	$ 6,283	100.0%	$ 4,163	100.0%

	At December 31,	
	2003	
	Amount	% of Total Loans (1)
	(Dollars in thousands)	
Balance applicable to:		
Commercial	$ 683	22.7%
Real estate – construction	672	24.2%
Real estate – mortgage	1,102	43.2%
Consumer	125	4.5%
Home equity lines of credit	139	5.4%
Unallocated	38	—
Total	$ 2,759	100.0%

(1) Represents total of all outstanding loans in each category as a percent of total loans outstanding.

Table of Contents

The following table sets forth for the periods indicated information regarding changes in the Company's allowance for loan losses:

	At or for the Years Ended December 31,				
	2007	2006	2005	2004	2003
	(Dollars in thousands)				
Balance at beginning of period	$ 9,405	$ 6,283	$ 4,163	$ 2,759	$ 1,721
Charge-offs:					
Commercial	(435)	(42)	—	—	(195)
Real estate	(404)	—	—	—	—
Consumer	(316)	(263)	(87)	(174)	(20)
Home equity lines of credit	—	—	—	—	—
Total charge-offs	(1,155)	(305)	(87)	(174)	(215)
Recoveries:					
Commercial	36	3	—	125	1
Real estate	—	—	—	—	—
Consumer	31	24	7	28	—
Home equity lines of credit	—	—	—	—	—
Total recoveries	67	27	7	153	1
Net charge-offs	(1,088)	(278)	(80)	(21)	(214)
Allowance acquired from The Bank Of Richmond acquisition	2,122	—	—	—	—
Allowance for loan losses on Loans purchased	—	—	—	—	52
Provision for loan losses charged to operations	4,900	3,400	2,200	1,425	1,200
Balance at end of period	$ 15,339	$ 9,405	$ 6,283	$ 4,163	$ 2,759
Ratio of net loan charge-offs to average loans outstanding	0.09%	0.04%	0.02%	0.01%	0.11%

INVESTMENT ACTIVITIES

The Company's portfolio of investment securities consist of trading securities, which are all US government and agency securities, and available for sale securities which consist primarily of U.S. Treasury and government agency securities, mortgage-backed securities, preferred stock in U.S. government agencies, corporate and municipal bonds, and common stock in several community banks.

Trading securities of $23 million at December 31, 2007 are carried at fair value, with unrealized gains and losses reported as a component of non-interest income. Trading securities are held principally for resale in the near term and provide short-term liquidity as part of the Company's asset/liability management strategy.

Securities to be held for indefinite periods of time and not intended to be held to maturity are classified as available for sale and carried at fair value with any unrealized gains or losses reflected as an adjustment to stockholders' equity. Securities held for indefinite periods of time include securities that management intends also to use as part of its asset/liability management strategy and that may be sold in response to changes in interest rates and/or significant prepayment risks. The following table summarizes the amortized costs, gross unrealized gains and losses and the resulting market value of securities available for sale:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
	(Dollars in thousands)			
December 31, 2007				
U.S. government agencies	$ 4,395	$ 68	$ —	$ 4,463
Corporate debt/equity securities	38,568	40	2,302	36,306
Mortgage-backed securities	72,889	650	3	73,536
Municipal securities	12,564	31	150	12,445
	$ 128,416	$ 789	$ 2,455	$ 126,750
December 31, 2006				
U.S. government agencies	$ 36,900	$ —	$ 922	$ 35,978
Corporate debt/equity securities	8,415	403	10	8,808
Mortgage-backed securities	42,748	9	616	42,141
Municipal securities	6,612	14	78	6,548
	$ 94,675	$ 426	$ 1,626	$ 93,475
December 31, 2005				
U.S. government agencies	$ 42,555	$ —	$ 1,327	$ 41,228
Corporate debt/equity securities	6,619	1,373	117	7,875
Mortgage-backed securities	67,935	13	581	67,367
Municipal securities	7,372	18	87	7,303
	$ 124,481	$ 1,404	$ 2,112	$ 123,773

The following table summarizes the amortized costs, fair values and weighted average yields, based on amortized cost, of securities available-for-sale at December 31, 2007, by contractual maturity groups:

	Amortized Cost	Fair Value	Weighted Average Yield
Corporate debt/equity securities:			
Due within one year	$ 7,864	$ 5,620	6.53%
Due after one but within five years	2,560	2,541	6.42%
Due after five but within ten years	3,016	3,017	5.45%
Due after ten years	25,128	25,128	8.28%
	38,568	36,306	7.58%
U.S. agency and mortgage-backed securities:			
Due after one but within five years	997	1,006	5.26%
Due after five but within ten years	4,197	4,267	5.19%
Due after ten years	72,090	72,726	5.41%
	77,284	77,999	5.39%
Municipal securities:			
Due within one year	595	593	2.54%
Due after one but within five years	1,204	1,196	3.90%
Due after five but within ten years	1,875	1,880	4.43%
Due after ten years	8,890	8,776	4.32%
	12,564	12,445	4.21%
Total securities available for sale:			
Due within one year	8,459	6,213	6.24%
Due after one but within five years	4,761	4,743	5.56%
Due after five but within ten years	9,088	9,164	5.00%
Due after ten years	106,108	106,630	6.08%
	$ 128,416	$126,750	5.89%

At December 31, 2007 there were no securities of any issuer (other than governmental agencies) that exceeded 10% of the Company's stockholders' equity.

SOURCES OF FUNDS

Deposit Activities

The Company provides a range of deposit services, including non-interest-bearing checking accounts, interest-bearing checking and savings accounts, money market accounts and certificates of deposit. These accounts generally earn interest at rates established by management based on competitive market factors and management's desire to increase or decrease certain types or maturities of deposits. The Company has used brokered deposits as a funding source. However, it strives to establish customer relations to attract core deposits in non-interest-bearing transactional accounts and thus to reduce its costs of funds.

The following table sets forth for the periods indicated the average balances outstanding and average interest rates for each major category of deposits.

	At December 31,					
	2007		2006		2005	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
	(Dollars in thousands)					
Interest-bearing NOW, money market and savings accounts	$ 330,980	3.47%	$245,038	3.23%	$178,577	2.00%
Time deposits	751,226	5.07%	450,786	4.56%	267,494	3.41%
Total interest-bearing deposits	1,082,206	4.58%	695,824	4.09%	446,071	2.85%
Demand and other non-interest-bearing deposits	116,190		93,346		79,901	
Total average deposits	$1,198,396	4.14%	$789,170	3.61%	$525,972	2.41%

Table of Contents

The following table sets forth at the dates indicated the amounts and maturities of certificates of deposit with balances of $100,000 or more at December 31, 2007:

	At December 31, 2007 (Dollars in thousands)
Remaining maturity:	
Less than three months	$ 80,263
Over three months through six months	122,529
Over six months through one year	49,443
Over one year through three years	15,024
Over three years through five years	4,015
Total	$ 271,274

Borrowings

As additional sources of funding, the Company uses advances from the Federal Home Loan Bank of Atlanta under a line of credit with a maximum borrowing availability not to exceed $432.1 million at December 31, 2007. Outstanding advances at December 31, 2007 were as follows:

Maturity	Interest Rate	(Dollars in thousands) 2007	2006
May 4, 2012	4.25%	$ 15,000	$ —
March 17, 2010	5.71%	1,500	1,500
November 10, 2010	5.43%	5,000	5,000
July 31, 2017	2.96%	7,500	—
August 7, 2017	2.88%	10,000	—
April 21, 2008	4.22%	5,000	5,000
April 25, 2012	4.85%	—	10,000
May 8, 2012	4.23%	10,000	—
September 17, 2012	3.78%	10,000	—
July 23, 2012	4.85%	—	10,000
September 19, 2012	3.80%	25,000	—
October 4, 2011	4.35%	—	20,000
October 24, 2011	4.35%	—	5,000
August 8, 2011	4.56%	—	35,000
November 23, 2007	5.50%	—	14,500
September 1, 2011	4.49%	—	10,000
September 27, 2012	3.72%	20,000	—
October 22, 2012	3.65%	25,000	—
July 25, 2012	4.53%	15,000	—
July 31, 2012	4.17%	7,500	—
August 28, 2012	3.99%	10,000	—
December 12, 2012	2.95%	7,500	—
		$ 174,000	$ 116,000

Pursuant to collateral agreements with the Federal Home Loan Bank, at December 31, 2007 advances are secured by investment securities available for sale with a fair value of $44.6 million and by loans with a carrying amount of $274.4 million, which approximates market value. The Company has a maximum borrowing availability from FHLB equal to $432.1 million at December 31, 2007.

The Company may purchase federal funds through six unsecured federal funds lines of credit aggregating $106.5 million. These lines are intended for short-term borrowings and are subject to restrictions limiting the frequency and term of advances. These lines of credit are payable on demand and bear interest based upon the daily federal funds rate (4.25% at December 31, 2007). The Company had $28.0 million and $0 outstanding on these lines of credit as of December 31, 2007 and 2006, respectively. The maximum amounts outstanding under these lines of credit at any month-end during 2007 and 2006 were $28.0 million and $35.0 million, respectively. The average amounts outstanding under these lines of credit were $12.8 million for 2007 and $11.0 million for 2006.

The Company entered into two reverse repurchase agreements in 2006 pursuant to a master repurchase agreement.

Each repurchase agreement is for $10.0 million, and is collateralized with mortgage backed securities with a similar fair market value. The first repurchase agreement, dated August 1, 2006 has a five year term. The interest rate on this agreement was 4.49% from August 1, 2006 through November 1, 2006. The interest rate was fixed at 4.99% on November 1, 2006 until it is repurchased by the counterparty on August 1, 2011. The agreement is callable by the counterparty on a quarterly basis. The second repurchase agreement, dated August 1, 2006 has a seven year term with a repurchase date of August 1, 2013. The interest rate of this agreement was 4.55% from August 1, 2006 through February 1, 2007, at which time it adjusted to a variable rate of 9.85% minus three month LIBOR (4.91% at December 31, 2007), not to exceed 5.85%, for the duration of the contract. The applicable interest rate in affect at December 31, 2007 was 4.94%. The agreement is callable by the counterparty on a quarterly basis.

In August of 2003, $8.0 million of trust preferred securities were placed through Gateway Capital Statutory Trust I (the "Trust"). The Trust issuer has invested the total proceeds from the sale of the Trust Preferred in Junior Subordinated Deferrable Interest Debentures (the "Junior Subordinated Debentures") issued by the Company. The trust preferred securities pay cumulative cash distributions quarterly at an annual rate, reset quarterly, equal to LIBOR plus 3.10%. The dividends paid to holders of the trust preferred securities, which are recorded as interest expense, are deductible for income tax purposes. The trust preferred securities are redeemable on or after September 17, 2008, in whole or in part. Redemption is mandatory at September 17, 2033. The Company has fully and unconditionally guaranteed the trust preferred securities through the combined operation of the debentures and other related documents. The Company's obligation under the guarantee is unsecured and subordinate to senior and subordinated indebtedness of the Company.

In June of 2004, $7.0 million of trust preferred securities were placed through Gateway Capital Statutory Trust II (the "Trust"). The Trust issuer has invested the total proceeds from the sale of the Trust Preferred Securities in Junior Subordinated Deferrable Interest Debentures (the "Junior Subordinated Debentures") issued by the Company. The trust preferred securities pay cumulative cash distributions quarterly at an annual rate, reset quarterly, equal to the 3 month LIBOR plus 2.65%. The dividends paid to holders of the trust preferred securities, which are recorded as interest expense, are deductible for income tax purposes. The trust preferred securities are redeemable on or after June 17, 2009, in whole or in part. Redemption is mandatory at June 17, 2034. The Company has fully and unconditionally guaranteed the trust preferred securities through the combined operation of the debentures and other related documents. The Company's obligation under the guarantee is unsecured and subordinate to senior and subordinated indebtedness of the Company.

In May of 2006, $15.0 million of trust preferred securities were placed through Gateway Capital Statutory Trust III (the "Trust"). The Trust issuer has invested the total proceeds from the sale of the Trust Preferred Securities in Junior Subordinated Deferrable Interest Debentures (the "Junior Subordinated Debentures") issued by the Company. The trust preferred securities pay cumulative cash distributions quarterly at an annual rate, reset quarterly, equal to the 3 month LIBOR plus 1.50%. The dividends paid to holders of the trust preferred securities, which are recorded as interest expense, are deductible for income tax purposes. The trust preferred securities are redeemable on or after May 30, 2011, in whole or in part. Redemption is mandatory at May 30, 2036. The Company has fully and unconditionally guaranteed the trust preferred securities through the combined operation of the debentures and other related documents. The Company's obligation under the guarantee is unsecured and subordinate to senior and subordinated indebtedness of the Company.

In May of 2007, $25.0 million of trust preferred securities were placed through Gateway Capital Statutory Trust IV (the "Trust"). The Trust issuer has invested the total proceeds from the sale of the Trust Preferred Securities in Junior Subordinated Deferrable Interest Debentures (the "Junior Subordinated Debentures") issued by the Company. The trust preferred securities pay cumulative cash distributions quarterly at an annual rate, reset quarterly, equal to the 3 month LIBOR plus 1.55%. The dividends paid to holders of the trust preferred securities, which are recorded as interest expense, are deductible for income tax purposes. The trust preferred securities are redeemable on or after May 31, 2012, in whole or in part. Redemption is mandatory at May 31, 2037. The Company has fully and unconditionally guaranteed the trust preferred securities through the combined operation of the debentures and other related documents. The Company's obligation under the guarantee is unsecured and subordinate to senior and subordinated indebtedness of the Company.

The trust preferred securities presently qualify as Tier 1 regulatory capital and are reported in Federal Reserve regulatory reports as a minority interest in a consolidated subsidiary. The junior subordinated debentures do not qualify as Tier 1 regulatory capital. On March 1, 2005, the Board of Governors of the Federal Reserve issued a final rule stating that trust preferred securities will continue to be included in Tier 1 capital, subject to stricter quantitative and qualitative standards. For Bank Holding Companies, after a transition period, under the new rule which is effective as of March 31, 2009, trust preferred securities will continue to be included in Tier 1 capital up to 25% of core capital elements (including trust preferred securities) net of goodwill less any associated deferred tax liability.

As of December 31, 2007 the Company has $408,000 of the trust preferred securities that did not qualify for Tier 1 capital and was included in Tier 2 capital.

In March 2007, the Company entered into a three year, $20,000,000 revolving line of credit agreement with a bank. Interest on the outstanding principal is based on 90 day LIBOR plus 1.25%, giving an interest rate of 6.57% at December 31, 2007. At December 31, 2007 the Company had $4,000,000 outstanding on the line of credit. The agreement requires that the Company must maintain certain financial ratios and remain well capitalized per regulatory guidelines. The Company was in compliance with all financial covenants as of December 31, 2007.

Interim Financial Information (Unaudited)

Consolidated quarterly results of operations were as follows:

	Three Months Ended			
	March 31,	June 30,	September 30,	December 31,
2007				
Interest income	$ 21,580	$ 26,047	$ 30,759	$ 31,173
Interest expense	11,541	14,338	17,200	17,395
Net interest income	10,039	11,709	13,559	13,778
Provision for loan losses	1,200	1,350	750	1,600
Noninterest income	4,649	3,117	6,118	3,881
Noninterest expense	9,526	10,417	12,353	12,645
Income before income tax expense	3,962	3,059	6,574	3,414
Income tax expense	1,448	1,040	2,358	1,144
Net income	$ 2,514	$ 2,019	$ 4,216	$ 2,270
Basic earnings per share	$ 0.23	$ 0.17	$ 0.33	$ 0.17
Diluted earnings per share	0.22	0.17	0.32	0.17
2006				
Interest income	$ 15,204	$ 18,031	$ 19,220	$ 20,642
Interest expense	6,982	8,719	9,727	10,671
Net interest income	8,222	9,312	9,493	9,971
Provision for loan losses	1,200	800	600	800
Noninterest income	1,013	1,296	4,416	2,545
Noninterest expense	7,840	8,559	9,018	9,557
Income before income tax expense	195	1,249	4,291	2,159
Income tax expense (benefit)	(29)	385	1,513	756
Net income	$ 224	$ 864	$ 2,778	$ 1,403
Basic earnings per share	$ 0.02	$ 0.08	$ 0.26	$ 0.13
Diluted earnings per share	0.02	0.08	0.25	0.13

Table of Contents

ITEM 8 – FINANCIAL STATEMENTS

GATEWAY FINANCIAL HOLDINGS, INC. & SUBSIDIARY
INDEX TO THE CONSOLIDATED FINANCIAL STATEMENTS

	Page No.
Report of Independent Registered Public Accounting Firm	50
Consolidated Balance Sheets as of December 31, 2007 and 2006	51
Consolidated Statements of Operations for the years ended December 31, 2007, 2006 and 2005	52
Consolidated Statements of Comprehensive Income for the years ended December 31, 2007, 2006 and 2005	53
Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2007, 2006 and 2005	54
Consolidated Statements of Cash Flows for the years ended December 31, 2007, 2006 and 2005	55
Notes to Consolidated Financial Statements	57

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors
Gateway Financial Holdings, Inc.
Virginia Beach, Virginia

We have audited the accompanying consolidated balance sheets of Gateway Financial Holdings, Inc. and subsidiary (the "Company") as of December 31, 2007 and 2006, and the related consolidated statements of operations, comprehensive income, changes in stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Gateway Financial Holdings, Inc. and subsidiary at December 31, 2007 and 2006 and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note B and Note L to the consolidated financial statements, effective January 1, 2007 the Company adopted the provisions of Statement of Financial Accounting Standards No. 157, "Fair Value Measurement," Statement of Financial Accounting Standards No. 159, "Fair Value Option for Financial Assets and Financial Liabilities," and FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," and effective January 1, 2006 adopted the provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payments."

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Gateway Financial Holdings, Inc. and subsidiary's internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 10, 2008, expressed an unqualified opinion.

Greenville, North Carolina
March 10, 2008

Table of Contents

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
December 31, 2007 and 2006

	2007	2006
	(In thousands, except share data)	
ASSETS		
Cash and due from banks	$ 19,569	$ 22,077
Interest-earning deposits in other banks	1,092	4,717
Trading securities (Note C)	23,011	—
Investment securities available for sale, at fair value (Note C)	126,750	93,475
Loans (Note D)	1,522,401	994,592
Allowance for loan losses (Note D)	(15,339)	(9,405)
NET LOANS	1,507,062	985,187
Accrued interest receivable	12,330	8,742
Stock in Federal Reserve Bank, at cost	5,348	3,609
Stock in Federal Home Loan Bank of Atlanta, at cost	10,312	6,970
Premises and equipment, net (Note E)	73,614	38,456
Intangible assets, net (Note R)	5,069	4,163
Goodwill (Notes O and R)	46,006	8,452
Bank-owned life insurance	26,105	25,051
Other assets	11,917	6,578
TOTAL ASSETS	$ 1,868,185	$ 1,207,477
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Demand	$ 123,885	$ 108,007
Savings	16,685	7,249
Money market and NOW	385,838	261,409
Time (Note F)	882,511	547,060
TOTAL DEPOSITS	1,408,919	923,725
Short term borrowings (Note G)	33,000	14,500
Long term borrowings (Note G) — $14,865 at fair value at December 31, 2007	249,102	152,429
Accrued expenses and other liabilities	12,757	7,183
TOTAL LIABILITIES	1,703,778	1,097,837
Commitments (Notes D and K)		
Stockholders' Equity (Notes J and N)		
Non-cumulative, perpetual preferred stock, $1,000 liquidation value per share, 1,000,000 shares authorized, 23,266 issued and outstanding at December 31, 2007 and none issued at December 31, 2006	23,182	—
Common stock, no par value, 30,000,000 shares authorized, 12,558,625 and 10,978,014 shares issued and outstanding at December 31, 2007 and 2006, respectively	127,258	101,669
Retained earnings	14,991	8,708
Accumulated other comprehensive loss	(1,024)	(737)
TOTAL STOCKHOLDERS' EQUITY	164,407	109,640
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 1,868,185	$ 1,207,477

See accompanying notes.

Table of Contents

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
Years Ended December 31, 2007, 2006 and 2005

	2007	2006	2005
	(Amounts in thousands, except per share data)		
INTEREST INCOME			
Interest and fees on loans	$ 102,041	$ 67,517	$ 36,358
Trading account securities	1,902	—	—
Investment securities available for sale			
Taxable	4,007	4,632	2,731
Tax-exempt	423	238	204
Interest-earning bank deposits	341	140	138
Other interest and dividends	845	570	248
TOTAL INTEREST INCOME	109,559	73,097	39,679
INTEREST EXPENSE			
Money market, NOW and savings deposits	11,491	7,918	3,579
Time deposits (Note F)	38,103	20,571	9,115
Short-term borrowings	1,367	2,429	1,140
Long-term borrowings	9,513	5,181	2,542
TOTAL INTEREST EXPENSE	60,474	36,099	16,376
NET INTEREST INCOME	49,085	36,998	23,303
PROVISION FOR LOAN LOSSES (Note D)	4,900	3,400	2,200
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	44,185	33,598	21,103
NON-INTEREST INCOME			
Service charges on deposit accounts	3,938	3,294	2,308
Mortgage operations	3,029	1,584	836
Insurance operations	5,245	2,883	2,388
Brokerage operations	794	744	656
Gain on sale of securities	163	842	282
Gain (Loss) on disposition of premises & equipment	—	(292)	6
Gain (loss) and net cash settlement on economic hedge (Note S)	584	(1,918)	—
Gain from trading securities	355	—	—
Income from bank-owned life insurance	1,054	864	679
Other service charges and fees	1,408	1,019	623
Other	1,195	250	289
TOTAL NON-INTEREST INCOME	17,765	9,270	8,067
NON-INTEREST EXPENSE			
Personnel costs	24,978	17,287	11,583
Occupancy and equipment	8,254	6,865	4,592
Data processing fees	1,990	1,652	941
Other (Note I)	9,719	9,170	6,150
TOTAL NON-INTEREST EXPENSE	44,941	34,974	23,266
INCOME BEFORE INCOME TAXES	17,009	7,894	5,904
INCOME TAXES (Note H)	5,990	2,625	1,965
NET INCOME	$ 11,019	$ 5,269	$ 3,939
NET INCOME PER COMMON SHARE			
Basic	$ 0.91	$ 0.49	$ 0.48
Diluted	$ 0.89	$ 0.47	$ 0.46

See accompanying notes.

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years Ended December 31, 2007, 2006 and 2005

	2007	2006	2005
		(Amounts in thousands)	
Net income	$ 11,019	$ 5,269	$ 3,939
Other comprehensive loss:			
Securities available for sale:			
Unrealized holding gains (losses) on available-for-sale securities	(1,863)	351	(67)
Tax effect	761	(127)	26
Reclassification of gains recognized in net income	(163)	(842)	(282)
Tax effect	61	316	109
Total other comprehensive loss	(1,204)	(302)	(214)
Comprehensive income	$ 9,815	$ 4,967	$ 3,725

See accompanying notes.

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years Ended December 31, 2007, 2006 and 2005

	Preferred Stock		Common Stock		Retained Earnings	Deferred Compensation - Restricted Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Amount	Shares	Amount				
	(Amounts in thousands, except share data)							
Balance at December 31, 2004	—	$ —	6,659,073	$ 62,726	$ 1,813	$ —	$ (221)	$ 64,318
Net income	—	—	—	—	3,939	—	—	3,939
Other comprehensive loss	—	—	—	—	—	—	(214)	(214)
Restricted stock awards	—	—	10,230	133	—	(133)	—	—
Unearned compensation	—	—	—	—	—	90	—	90
Issuance of shares pursuant to dividend reinvestment plan	—	—	9,025	147	—	—	—	147
Shares issued from options exercise	—	—	142,159	1,225	—	—	—	1,225
Issuance of common stock	—	—	2,000,000	29,855	—	—	—	29,855
Shares issued in 11-for-10 stock split effected as a 10% stock dividend	—	—	671,740	—	—	—	—	—
Tax benefits from the exercise of options	—	—	—	12	—	—	—	12
Sale of common stock	—	—	1,213	11	—	—	—	11
Cash dividends ($0.09 per share)	—	—	—	—	(631)	—	—	(631)
Cash paid for fractional shares	—	—	—	—	(8)	—	—	(8)
Balance at December 31, 2005	—	—	9,493,440	94,109	5,113	(43)	(435)	98,744
Net income	—	—	—	—	5,269	—	—	5,269
Other comprehensive loss	—	—	—	—	—	—	(302)	(302)
Issuance of restricted stock awards	—	—	12,500	—	—	—	—	—
Stock based compensation related to restricted stock	—	—	—	171	—	—	—	171
Stock based compensation related to stock options	—	—	—	51	—	—	—	51
Adjustment to deferred compensation for the adoption of SFAS No. 123(R)	—	—	—	(43)	—	43	—	—
Issuance of shares pursuant to dividend reinvestment plan	—	—	32,573	515	—	—	—	515
Shares issued for subsidiary acquisitions	—	—	143,966	2,088	—	—	—	2,088
Shares issued from options exercise	—	—	13,763	102	—	—	—	102
Shares issued upon exercise of overallotment option	—	—	300,000	4,383	—	—	—	4,383
Shares issued in 11 for 10 stock split effected as a 10% stock dividend	—	—	981,772	—	—	—	—	—
Tax benefits from the exercise of options	—	—	—	293	—	—	—	293
Cash dividends ($0.16 per share)	—	—	—	—	(1,674)	—	—	(1,674)
Balance at December 31, 2006	—	—	10,978,014	101,669	8,708	—	(737)	109,640
Net income	—	—	—	—	11,019	—	—	11,019
Cumulative effect adjustment resulting from the adoption of SFAS No. 159, net of tax	—	—	—	—	(1,197)	—	917	(280)
Other comprehensive loss	—	—	—	—	—	—	(1,204)	(1,204)
Issuance of restricted stock awards	—	—	61,500	—	—	—	—	—

Issuance of non-cumulative, perpetual preferred stock	23,266	23,182	—	—	—	—	—	23,182
Stock based compensation related to restricted stock	—	—	—	278	—	—	—	278
Stock based compensation related to stock options	—	—	—	102	—	—	—	102
Issuance of shares pursuant to dividend reinvestment plan	—	—	30,122	433	—	—	—	433
Acquisition of The Bank of Richmond:								
Common stock issued	—	—	1,845,631	26,168				26,168
Fair value of stock options assumed	—	—	—	3,624				3,624
Shares issued for subsidiary acquisitions	—	—	29,502	425	—	—	—	425
Shares issued from options exercise	—	—	14,493	116	—	—	—	116
Tax benefits from the exercise of options	—	—	—	43	—	—	—	43
Shares repurchased	—	—	(400,637)	(5,600)	—	—	—	(5,600)
Cash dividends on common stock ($0.29 per share)	—	—	—	—	(3,461)	—	—	(3,461)
Cash dividends on non-cumulative, perpetual preferred stock	—	—	—	—	(78)	—	—	(78)
Balance at December 31, 2007	23,266	$23,182	12,558,625	$127,258	$ 14,991	$ —	$ (1,024)	$ 164,407

See accompanying notes.

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2007, 2006 and 2005

	2007	2006	2005
		(Amounts in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$ 11,019	$ 5,269	$ 3,939
Adjustments to reconcile net income to net cash provided (used) by operating activities:			
Amortization of intangibles	558	361	379
Depreciation and amortization	2,834	2,444	1,761
(Gain) loss on market value of economic hedge	(1,225)	1,225	—
Deferred income taxes	(270)	(1,319)	(185)
Realized gain on available-for-sale securities	(163)	(842)	(282)
Unrealized and realized gain on trading securities	(355)	—	—
Income from bank-owned life insurance	(1,054)	(864)	(680)
Realized gain on sale of loans	(48)	(56)	(127)
Proceeds from sale of loans	586	799	2,536
Unrealized gain on fair value on junior subordinated debt	(960)	—	—
Proceeds from sale of mortgage loans held for sale	183,473	58,593	—
Mortgage loan originations held for sale	(173,521)	(74,169)	—
Realized (gain) loss on sale of premises and equipment	—	292	(6)
Provision for loan losses	4,900	3,400	2,200
Stock based compensation	380	222	—
Deferred compensation – restricted stock	—	—	90
Change in assets and liabilities:			
Increase in accrued interest receivable	(2,714)	(2,859)	(3,186)
Increase in other assets	(4,230)	(171)	(1,360)
Increase in accrued expenses and other liabilities	5,233	2,594	1,526
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	24,443	(5,081)	6,605
CASH FLOWS FROM INVESTING ACTIVITIES			
Cash received (paid) from investment securities available for sale transactions:			
Purchases of available-for-sale securities	(115,102)	(7,621)	(58,113)
Maturities and calls of available-for-sale securities	10,714	15,055	5,106
Proceeds from sale of available-for-sale securities	21,518	23,133	21,540
Cash received (paid) from trading securities transactions:			
Purchases of trading securities	(69,962)	—	—
Maturities and calls of trading securities	56,000	—	—
Proceeds from sale of trading securities	42,315	—	—
Cash and cash equivalents acquired with The Bank of Richmond acquisition	17,974	—	—
Cash paid for The Bank of Richmond acquisition	(26,710)	—	—
Cash paid for subsidiary acquisition	(445)	—	—
Net increase in loans from originations and repayments	(370,907)	(313,385)	(287,185)
Proceeds from sale of bank premises and equipment	—	6	234
Purchase of premises and equipment	(29,195)	(11,528)	(12,408)
Purchase of Federal Reserve Bank stock	(1,739)	(1,512)	(1,375)
Purchase of Federal Home Loan Bank stock	(3,018)	(762)	(3,887)
Purchase of bank owned life insurance	—	(7,000)	—
NET CASH USED BY INVESTING ACTIVITIES	(468,557)	(303,614)	(336,088)
CASH FLOWS FROM FINANCING ACTIVITIES			
Increase in deposits	307,622	277,463	240,003
Net increase (decrease) in short-term borrowings	18,450	(47,500)	21,339
Net increase in long term borrowings	71,500	64,300	49,400
Proceeds from issuance of junior subordinated debentures	25,774	15,464	—
Proceeds from exercise of stock options	116	102	1,237
Proceeds from issuance of common stock	—	4,383	29,866
Proceeds from issuance of preferred stock	23,182	—	—
Proceeds from dividend reinvestment	433	515	147
Repurchase of common stock	(5,600)	—	—
Cash paid for dividends	(3,539)	(1,674)	(631)
Tax benefit from the exercise of stock options	43	293	—
Cash paid for fractional shares	—	—	(8)
NET CASH PROVIDED BY FINANCING ACTIVITIES	437,981	313,346	341,353
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(6,133)	4,651	11,870
CASH AND CASH EQUIVALENTS, BEGINNING	26,794	22,143	10,273
CASH AND CASH EQUIVALENTS, ENDING	$ 20,661	$ 26,794	$ 22,143

See accompanying notes.

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
Years Ended December 31, 2007, 2006 and 2005

	2007	2006	2005
	(Amounts in thousands)		
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION			
Interest paid	$ 56,243	$ 34,656	$15,689
Income taxes paid	$ 7,931	$ 3,723	$ 748
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING ACTIVITIES			
Transfer from loans to real estate owned	$ 482	$ —	$ —
Investments securities transferred from available for sale to trading	$ 51,012	$ —	$ —
Unrealized holding losses on available-for-sale securities, net	$ (1,204)	$ (302)	$ (214)
Business combinations:			
Fair value of assets acquired	$236,560	$ 2,740	$ —
Fair value of liabilities assumed	$179,188	$ 652	$ —
Fair value of common stock issued and stock options assumed	$ 30,217	$ 2,088	$ —

See accompanying notes.

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE A — ORGANIZATION AND OPERATIONS

Gateway Bank & Trust Co. (the "Bank") was incorporated November 24, 1998 and began banking operations on December 1, 1998. Effective October 1, 2001, the Bank became a wholly-owned subsidiary of Gateway Financial Holdings, Inc. (the "Company"), a financial holding company whose principal business activity consists of the ownership of the Bank, Gateway Capital Statutory Trust I, Gateway Capital Statutory Trust II, Gateway Capital Statutory Trust III, and Gateway Capital Statutory Trust IV.

The Bank is engaged in general commercial and retail banking in Eastern and Central North Carolina and in the Richmond and Tidewater area of Southeastern Virginia, operating under state banking laws and the rules and regulations of the Federal Reserve System and the North Carolina Commissioner of Banks. The Bank undergoes periodic examinations by those regulatory authorities.

The Bank has four wholly-owned subsidiaries: Gateway Investment Services, Inc., whose principal activity is to engage in brokerage services as an agent for non-bank investment products and services; Gateway Insurance Services, Inc., an independent insurance agency with offices in Edenton, Hertford, Elizabeth City, Moyock, Plymouth and Kitty Hawk, North Carolina and Chesapeake and Newport News, Virginia; Gateway Bank Mortgage, Inc. with offices in Raleigh, Elizabeth City and Kitty Hawk, North Carolina and Norfolk and Virginia Beach, Virginia which began operations during the second quarter of 2006 whose principal activity is to engage in originating, processing and sale of mortgage loans; and Gateway Title Agency, Inc., acquired in February 2007, with offices in Newport News, Hampton and Virginia Beach, Virginia, whose principal activity is to engage in title services for real estate transactions.

The Company formed Gateway Capital Statutory Trust I in 2003, Gateway Capital Statutory Trust II in 2004, Gateway Capital Statutory Trust III in 2006, and Gateway Capital Statutory Trust IV in May 2007, all of which are wholly owned by the Company, to facilitate the issuance of trust preferred securities totaling $8.0 million, $7.0 million $15.0 million, and $25.0 million respectively. Adoption of FASB Interpretation No. (FIN) 46, *Consolidation of Variable Interest Entities* resulted in the deconsolidation of Gateway Capital Trust I and II. Upon deconsolidation, the junior subordinated debentures issued by the Company to the trusts were included in long-term borrowings and the Company's equity interest in the trusts was included in other assets. The deconsolidation of the trusts did not materially impact net income.

Generally, trust preferred securities qualify as Tier 1 regulatory capital and are reported in Federal Reserve regulatory reports as a minority interest in a consolidated subsidiary. The junior subordinated debentures do not qualify as Tier 1 regulatory capital. On March 1, 2005, the Board of Governors of the Federal Reserve issued the final rule that retains the inclusion of trust preferred securities in Tier 1 capital of bank holding companies, but with stricter quantitative limits and clearer qualitative standards. After a transition period, under the new rule which is effective as of March 31, 2009, the aggregate amount of trust preferred securities and certain other capital elements will be limited to 25 percent of Tier 1 capital elements, net of goodwill less any associated deferred tax liability. The amount of trust preferred securities and certain other elements in excess of the limit could be included in Tier 2 capital, subject to restrictions. Currently the Company has $408,000 of the trust preferred securities that do not qualify for Tier 1 capital and is included in Tier 2 capital.

NOTE B — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of Gateway Financial Holdings, Inc. and Gateway Bank & Trust Co., and its four wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

NOTE B — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses.

Cash and Cash Equivalents

For the purpose of presentation in the consolidated statement of cash flows, cash and cash equivalents are defined as those amounts included in the balance sheet captions "Cash and due from banks" and "Interest-earning deposits in other banks."

Investment Securities Held to Maturity

Investment securities that management has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity.

Trading Securities

Investment securities classified as trading securities are held principally for resale in the near term and are reported at fair value in the consolidated balance sheet at December 31, 2007. Realized and unrealized gains and looses are determined using the specific identification method and are recognized as a component of non-interest income. Interest and dividends are included in net interest income.

Investment Securities Available for Sale

Investment securities available for sale are reported at fair value and consist of debt instruments that are not classified as either trading securities or as held to maturity securities. Unrealized holding gains and losses, net of deferred income tax, on available for sale securities are reported as a net amount in other comprehensive income. Gains and losses on the sale of investment securities available for sale are determined using the specific-identification method. Declines in the fair value of individual held to maturity and investment securities available for sale below their cost that are other than temporary would result in write-downs of the individual securities to their fair value. Such write-downs would be included in earnings as realized losses. Premiums and discounts are recognized in interest income using the interest method over the period to maturity.

Mortgage Loans Held for Sale

The Company originates single family, residential first mortgage loans that have been approved by secondary investors. Loans held for sale are carried at the lower of cost or fair value in the aggregate as determined by outstanding commitments from investors. The Company issues a rate lock commitment to a customer and concurrently "locks in" with a secondary market investor under a best efforts delivery system. Within several weeks of closing, these loans, together with their servicing rights, are sold to other financial institutions under prearranged terms. The Company recognizes certain origination and service release fees upon the sale, which are included in mortgage operations which is part of non-interest income in the consolidated statement of operations.

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE B — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity are reported at their outstanding principal adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan. The accrual of interest on impaired loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. When loans become classified as non-accrual loans interest accrual is discontinued. Interest income is subsequently recognized only to the extent cash payments are received. Loans may be returned to accrual status when all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within an acceptable period of time and there is a sustained period of repayment performance (generally a minimum of six months) by the borrower in accordance with the contractual terms of interest and principal.

Allowance for Loan Losses

The provision for loan losses is based upon management's estimate of the amount needed to maintain the allowance for loan losses at an adequate level. In making the evaluation of the adequacy of the allowance for loan losses, management gives consideration to current economic conditions, statutory examinations of the loan portfolio by regulatory agencies, delinquency information and management's internal review of the loan portfolio. Loans are considered impaired when it is probable amounts will not be collected in accordance to the contractual terms of the loan agreement. The measurement of impaired loans is generally based on the present value of expected future cash flows discounted at the historical effective interest rate, or upon the fair value of the collateral if collateral dependent. If the recorded investment in the loan (including accrued and unpaid interest) exceeds the measure of fair value, a valuation allowance is established as a component of the allowance for loan losses. While management uses the best information available to make evaluations, future adjustments to the allowance may be necessary if conditions differ substantially from the assumptions used in making the evaluations. In addition, regulatory examiners may require the Bank to recognize adjustments to the allowance for loan losses based on their judgments about information available to them at the time of their examination.

Foreclosed Real Estate

Real estate acquired through, or in lieu of, loan foreclosure is initially recorded at fair value less estimated cost to sell at the date of foreclosure establishing a new cost basis. After foreclosure, valuations of the property are periodically performed by management and the real estate is carried at the lower of cost or fair value minus estimated cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other non-interest expense.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on the straight-line method over the estimated useful asset lives of 3 - 10 years for furniture and equipment, 3 — 5 years for vehicles, and 40 years for bank premises. Leasehold improvements are amortized over the terms of the respective leases or the estimated useful lives of the improvements, whichever is shorter. Repairs and maintenance costs are charged to operations as incurred and additions and improvements to premises and equipment are capitalized. Upon sale or retirement, the cost and related accumulated depreciation are removed from the accounts and any gains or losses are reflected in current operations.

NOTE B — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Federal Home Loan Bank and Federal Reserve Bank Stock

As a requirement for membership, the Company invests in stock of the Federal Home Loan Bank of Atlanta ("FHLB") and the Federal Reserve Bank ("FRB"). These investments are carried at cost. Due to the redemption provisions of these entities, the Company estimated that fair value equals cost and that these investments were not impaired at December 31, 2007.

Intangible Assets and Goodwill

Intangible assets include goodwill and other identifiable assets, such as core deposit premiums, resulting from acquisitions. Core deposit premiums are amortized primarily on a straight-line basis over a ten-year life based upon historical studies of core deposits. Intangible assets related to insurance agency acquisitions are amortized over the expected life of the book of business acquired. Goodwill is not amortized but is tested annually for impairment or at any time an event occurs or circumstances change that may trigger a decline in the value of the reporting unit. Examples of such events or circumstances include adverse changes in legal factors, business climate, unanticipated competition, change in regulatory environment or loss of key personnel.

The Company tests for impairment in accordance with SFAS No. 142. Potential impairment of goodwill exists when the carrying amount of a reporting unit exceeds its fair value. The fair value of a reporting unit is computed using one or a combination of the following three methods: income, market value or cost method. The income method uses a discounted cash flow analysis to determine fair value by considering a reporting unit's capital structure and applying a risk-adjusted discount rate to forecast earnings based on a capital asset pricing model. The market value method uses recent transaction analysis or publicly traded comparable analysis for similar assets and liabilities to determine fair value. The cost method assumes the net assets of a recent business combination accounted for under the purchase method of accounting will be recorded at fair value if no event or circumstance has occurred triggering a decline in the value. To the extent a reporting unit's carrying amount exceeds its fair value, an indication exists that the reporting unit's goodwill may be impaired, and a second step of impairment test will be performed. In the second step, the implied fair value of the reporting unit's goodwill, determined by allocating the reporting unit's fair value to all of its assets (recognized and unrecognized) and liabilities as if the reporting unit had been acquired in a business combination at the date of the impairment test. If the implied fair value of reporting unit goodwill is lower than its carrying amount, goodwill is impaired and is written down to its implied fair value. The loss recognized is limited to the carrying amount of goodwill. Once an impairment loss is recognized, future increases in fair value will not result in the reversal of previously recognized losses.

Income Taxes

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax assets are also recognized for operating loss carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which the temporary differences are expected to be recovered or settled. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that the tax benefits will not be realized.

The Company adopted the Financial Accounting Standards Board's Interpretation No. 48 "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109" ("FIN 48"), effective January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the financial statements and requires the impact of a tax position to be recognized in the financial statements if that position is more likely than not of being sustained by the taxing authority. The adoption of FIN 48 did not have a material effect on our consolidated financial position or results of operations and unrecognized tax benefits as of December 31, 2007, and 2006. The balance of unrecognized tax benefits were immaterial at December 31, 2007 and 2006. The Company classifies interest and penalties related to income tax assessments, if any, in income tax expense in the consolidated statement of operations and interest and penalties recognized in 2007, 2006, and 2005 were immaterial. Fiscal years ending on or after December 31, 2003 are subject to examination by federal and state tax authorities.

NOTE B — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Comprehensive Income

The Company reports as comprehensive income all changes in stockholders' equity during the year from sources other than stockholders. Other comprehensive income refers to all components (revenues, expenses, gains, and losses) of comprehensive income that are excluded from net income. The Company's only component of other comprehensive income is unrealized gains and losses on investment securities available for sale.

Mortgage Operations

The Bank originates single family, residential first mortgage loans that have been approved by secondary investors. For a portion of 2006 and prior years, such loans were closed by a third party and therefore are not shown in the Company's consolidated financial statements. The Bank recognizes certain origination and service release fees upon the sale, which are included in non-interest income on the statements of operations under the caption "Mortgage operations." Also included under this caption is income derived from investments in certain mortgage companies for a portion of 2006 and prior years. During 2006 the Bank ceased using a third party to close such loans after it opened its wholly owned mortgage subsidiary, Gateway Bank Mortgage, Inc., at which time mortgage loan originations were closed by the mortgage company with the related fees and expenses recorded in the consolidated financial statements.

Stock Compensation Plans

The Company has four share-based compensation plans in effect at December 31, 2007. Effective January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), "Share-Based Payment," ("SFAS No. 123R") which was issued by the FASB in December 2004. SFAS No. 123R revises SFAS No. 123 "Accounting for Stock Based Compensation," and supersedes APB No. 25, "Accounting for Stock Issued to Employees," (APB No. 25) and its related interpretations. SFAS No. 123R requires recognition of the cost of employee services received in exchange for an award of equity instruments in the financial statements over the period the employee is required to perform the services in exchange for the award (usually the vesting period). SFAS No. 123R also requires measurement of the cost of employee services received in exchange for an award based on the grant-date fair value of the award. SFAS No. 123R also amends SFAS No. 95 "Statement of Cash Flows," to require that excess tax benefits be reported as financing cash inflows flows, rather than as a reduction of taxes paid, which is included within operating cash flows.

The Company adopted SFAS No. 123R using the modified prospective application as permitted under SFAS No. 123R. Accordingly, prior period amounts have not been restated. Under this application, the Company is required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding at the date of adoption.

Prior to the adoption of SFAS No. 123R, the Company used the intrinsic value method as prescribed by APB No. 25 and thus recognized no compensation expense for options granted with exercise prices equal to the fair market value of the Company's common stock on the date of the grant.

Per Share Results

Basic earnings per share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate to outstanding stock options and are determined using the treasury stock method.

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE B — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Per Share Results (Continued)

The basic and diluted weighted average shares outstanding are as follows:

	2007	2006	2005
Weighted average outstanding shares used for basic EPS	11,960,932	10,811,980	8,214,118
Plus incremental shares from assumed exercise of:			
Stock options	362,712	293,166	339,275
Restricted stock	23,226	16,557	2,619
Weighted average outstanding shares used for diluted EPS	12,346,870	11,121,703	8,556,012

On May 16, 2005, the Company's Board of Directors declared a 11-for-10 stock split, effected in the form of a 10% stock dividend, which was distributed June 20, 2005 to stockholders of record on May 30, 2005. In 2006 the Board of Directors declared an 11-for-10 stock split, effected in the form of a 10% stock dividend, which was distributed May 15, 2006 to stockholders of record on April 28, 2006. All references to per share results and weighted average common and common equivalent shares outstanding have been adjusted to reflect the effects of these stock splits.

In December 2007 the Board declared a cash preferred stock dividend of $78,085 to shareholders of record, payable on January 15, 2008. The preferred stock dividend was deducted from 2007 net income in the computation of diluted earnings per share. There were no adjustments required to be made to net income in the computation of diluted earnings per share during 2006 and 2005. For the years ended December 31, 2007, 2006 and 2005, there were 324,013, 162,250 and 126,000 options, respectively, that were antidilutive since the exercise price for these options exceeded the average market price of the Company's common stock for the year.

Derivative financial instruments

For asset/liability management purposes, the Company has used interest rate swap agreements to hedge various exposures or to modify interest rate characteristics of various balance sheet accounts. Such derivatives are used as part of the asset/liability management process and are linked to specific assets or liabilities, and have a high correlation between the contract and the underlying item being hedged, both at inception and throughout the hedge period.

Under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" requires that changes in the fair market value of derivative financial instruments that do not qualify for hedge accounting treatment be reported as an economic gain or loss in non-interest income.

Fair value measurements

Effective January 1, 2007, the Company elected early adoption of Statements of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements" and SFAS No. 159 "The Fair Value Option for Financial Assets and Liabilities". SFAS No. 157, which was issued in September 2006, establishes a framework for using fair value. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 159, which was issued in February 2007, generally permits the measurement of selected eligible financial instruments at fair value at specified election dates. Upon adoption of SFAS No. 159, the Company selected the fair value measurement option for various pre-existing financial assets and liabilities, including certain short-term investment securities used primarily for liquidity and asset liability management purposes in the available for sale portfolio totaling approximately $51 million; and junior subordinated debentures issued to unconsolidated capital trusts of $15.5 million. The initial fair value measurement of these items resulted in, approximately, a $1.2 million cumulative-effect adjustment, net of tax, recorded as a reduction in retained earnings as of January 1, 2007.

NOTE B — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Under SFAS No. 159, this one-time charge was not recognized in current earnings.

Recent Accounting Pronouncements

In 2006 the Emerging Issues Task Force issued EITF Issue 06-4 "Accounting for Deferred Compensation and Postretirement Benefits Aspects of Endorsement Split-Dollar Life Insurance Arrangements" requires the recognition of a liability related to the postretirement benefits covered by an endorsement split-dollar life insurance arrangement. The employer (who is also the policyholder) has a liability for the benefit it is providing to its employee. As such, if the policyholder has agreed to maintain the insurance policy in force for the employee's benefit during his or her retirement, then the liability recognized during the employee's active service period should be based on the future cost of insurance to be incurred during the employee's retirement. Alternatively, if the policyholder has agreed to provide the employee with a death benefit, then the liability for the future death benefit should be recognized by following the guidance in Statement 106 or Opinion 12, as appropriate. This issue is applicable for interim or annual reporting periods beginning after December 15, 2007. The Company has determined that it will have to establish an initial liability of approximately $400,000 as of January 1, 2008, and will reduce net income by approximately $100,000 in 2008 to comply with this EITF.

In December 2007, the FASB issued SFAS 141(R), "Business Combinations." SFAS 141(R) will significantly change how entities apply the acquisition method to business combinations. The most significant changes affecting how the Company will account for business combinations under this Statement include: the acquisition date will be the date the acquirer obtains control; all (and only) identifiable assets acquired, liabilities assumed, and noncontrolling interests in the acquiree will be stated at fair value on the acquisition date; assets or liabilities arising from noncontractual contingencies will be measured at their acquisition date fair value only if it is more likely than not that they meet the definition of an asset or liability on the acquisition date; adjustments subsequently made to the provisional amounts recorded on the acquisition date will be made retroactively during a measurement period not to exceed one year; acquisition-related restructuring costs that do not meet the criteria in SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities," will be expensed as incurred; transaction costs will be expensed as incurred; reversals of deferred income tax valuation allowances and income tax contingencies will be recognized in earnings subsequent to the measurement period; and the allowance for loan losses of an acquiree will not be permitted to be recognized by the acquirer. Additionally, SFAS 141(R) will require new and modified disclosures surrounding subsequent changes to acquisition-related contingencies, contingent consideration, noncontrolling interests, acquisition-related transaction costs, fair values and cash flows not expected to be collected for acquired loans, and an enhanced goodwill rollforward. The Company will be required to prospectively apply SFAS 141(R) to all business combinations completed on or after January 1, 2009. Early adoption is not permitted. For business combinations in which the acquisition date was before the effective date, the provisions of SFAS 141(R) will apply to the subsequent accounting for deferred income tax valuation allowances and income tax contingencies and will require any changes in those amounts to be recorded in earnings. Management is currently evaluating the effects that SFAS 141(R) will have on the financial condition, results of operations, liquidity, and the disclosures that will be presented in the consolidated financial statements.

NOTE B — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements (Continued)

In December 2007, the FASB issued SFAS 160, "Noncontrolling interests in Consolidated Financial Statements," an Amendment of ARB 51. SFAS 160 establishes new accounting and reporting standards for noncontrolling interests in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 will require entities to classify noncontrolling interests as a component of stockholders' equity and will require subsequent changes in ownership interests in a subsidiary to be accounted for as an equity transaction. Additionally, SFAS 160 will require entities to recognize a gain or loss upon the loss of control of a subsidiary and to remeasure any ownership interest retained at fair value on that date. This statement also requires expanded disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS 160 is effective on a prospective basis for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, except for the presentation and disclosure requirements, which are required to be applied retrospectively. Early adoption is not permitted. Management is currently evaluating the effects, if any, that SFAS 160 will have upon adoption as this standard will affect the presentation and disclosure of noncontrolling interests in the consolidated financial statements.

In June 2007, the FASB ratified the consensus reached in EITF 06-11, Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards. EITF 06-11 applies to entities that have share-based payment arrangements that entitle employees to receive dividends or dividend equivalents on equity-classified nonvested shares when those dividends or dividend equivalents are charged to retained earnings and result in an income tax deduction. Entities that have share-based payment arrangements that fall within the scope of EITF 06-11 will be required to increase capital surplus for any realized income tax benefit associated with dividends or dividend equivalents paid to employees for equity classified nonvested equity awards. Any increase recorded to capital surplus is required to be included in an entity's pool of excess tax benefits that are available to absorb potential future tax deficiencies on share-based payment awards. The Company adopted EITF 06-11 on January 1, 2008 for dividends declared on share-based payment awards subsequent to this date. The impact of adoption is not expected to have a material impact on financial condition, results of operations, or liquidity.

In November 2007, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 109, which addresses the valuation of written loan commitments accounted for at fair value through earnings. The guidance in SAB 109 expresses the staff's view that the measurement of fair value for a written loan commitment accounted for at fair value through earnings should incorporate the expected net future cash flows related to the associated servicing of the loan. Previously under SAB 105, Application of Accounting Principles to Loan Commitments, this component of value was not incorporated into the fair value of the loan commitment. The impact of SAB 109 will be to accelerate the recognition of the estimated fair value of the servicing inherent in the loan to the commitment date. Management is currently evaluating the effects that SAB 109 will have on the financial condition, results of operations, liquidity, and the disclosures that will be presented in the consolidated financial statements.

From time to time, the FASB issues exposure drafts for proposed statements of financial accounting standards. Such exposure drafts are subject to comment from the public, to revisions by the FASB and to final issuance by the FASB as statements of financial accounting standards. Management considers the effect of the proposed statements on the consolidated financial statements of the Company and monitors the status of changes to and proposed effective dates of exposure drafts.

Reclassifications

Certain amounts in the 2006 and 2005 consolidated financial statements have been reclassified to conform to the 2007 presentation. The reclassifications had no effect on net income or stockholders' equity as previously reported.

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE C — INVESTMENT SECURITIES

Trading assets consisted of U.S government and agency securities with a fair value of approximately $23 million at December 31, 2007.

The following is a summary of the available for sale securities portfolio by major classification:

	December 31, 2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Securities available-for-sale:				
U. S. government securities and obligations of U.S. government agencies	$ 4,395	$ 68	$ —	$ 4,463
Corporate debt/equity securities	38,568	40	2,302	36,306
Mortgage-backed securities	72,889	650	3	73,536
Municipal securities	12,564	31	150	12,445
	$ 128,416	$ 789	$ 2,455	$ 126,750

	December 31, 2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Securities available-for-sale:				
U. S. government securities and obligations of U.S. government agencies	$ 36,900	$ —	$ 922	$ 35,978
Corporate debt/equity securities	8,415	403	10	8,808
Mortgage-backed securities	42,748	9	616	42,141
Municipal securities	6,612	14	78	6,548
	$ 94,675	$ 426	$ 1,626	$ 93,475

The following tables show our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, at December 31, 2007 and 2006. For available for sale securities, the unrealized losses relate to seven corporate debt and equity securities, twenty-five municipal securities and two mortgage-backed securities. All investment securities with unrealized losses are considered by management to be temporarily impaired given the credit ratings on these investment securities and management's intent and ability to hold these securities until recovery. Management has concluded that the unrealized losses related to the corporate equity securities will recover in a reasonable amount of time. These investments are primarily in community banks, whose valuations have been reduced by the overall market sentiment towards the financial industry in general, and not reflective of poor financial performance on any of these institutions. Should the Company decide in the future to sell securities in an unrealized loss position, or determine that impairment of any securities is other than temporary, irrespective of a decision to sell, an impairment loss would be recognized in the period such determination is made.

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE C — INVESTMENT SECURITIES (Continued)

	2007					
	Less Than 12 Months		12 Months or More		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
	(Dollars in thousands)					
Securities available for sale:						
Corporate debt/equity securities	$ 7,137	$ 2,244	$ 961	$ 58	$ 8,098	$ 2,302
Mortgage-backed securities	249	1	1,017	2	1,266	3
Municipal securities	7,590	130	2,491	20	10,081	150
Total temporarily impaired securities	$ 14,976	$ 2,375	$ 4,469	$ 80	$ 19,445	$ 2,455

	2006					
	Less Than 12 Months		12 Months or More		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
	(Dollars in thousands)					
Securities available for sale:						
U.S. government securities and obligations of U.S. government agencies	$ —	$ —	$ 35,978	$ 922	$ 35,978	$ 922
Corporate	—	—	1,542	10	1,542	10
Mortgage-backed securities	21,749	302	7,989	314	29,738	616
Municipal securities	1,313	12	2,924	66	4,237	78
Total temporarily impaired securities	$ 23,062	$ 314	$ 48,433	$ 1,312	$ 71,495	$ 1,626

Proceeds from maturities, sales and calls of investment securities available-for-sale during the years ended December 31, 2007, 2006 and 2005 were $32.2 million, $38.2 million and $26.6 million, respectively. From those transactions, the Company realized gross gains of $163,000, $842,000 and $333,000 and gross losses of $0, $0 and $52,000 in 2007, 2006 and 2005, respectively.

The amortized cost and fair values of securities available-for-sale at December 31, 2007 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(Dollars in thousands)	
Due within one year	$ 8,459	$ 6,213
Due after one year through five years	4,761	4,743
Due after five years through ten years	9,088	9,164
Due after ten years	106,108	106,630
	$ 128,416	$ 126,750

NOTE C — INVESTMENT SECURITIES (Continued)

For purposes of the maturity table, mortgage-backed securities, which are not due at a single maturity date, have been allocated over maturity groupings based on the weighted-average contractual maturities of underlying collateral. The mortgage-backed securities may mature earlier than their weighted-average contractual maturities because of principal prepayments. Equity securities are shown as due within one year.

Securities with an amortized cost of $83.3 million and a fair value of $83.8 million were pledged to secure FHLB advances, reverse repurchase agreements, and public monies on deposit as required by law at December 31, 2007.

NOTE D — LOANS

A summary of the balances of loans follows:

	December 31,	
	2007	2006
	(Dollars in thousands)	
Commercial and industrial	$ 263,283	$137,658
Real estate – construction, acquisition and development	604,335	381,788
Real estate – commercial mortgage	321,806	229,752
Mortgage loans held for sale	5,624	15,576
Real estate – 1- 4 family mortgage	193,549	128,920
Consumer	22,133	15,347
Home equity lines of credit	113,191	85,882
Subtotal	1,523,921	994,923
Less: Allowance for loan losses	(15,339)	(9,405)
Unamortized net deferred fees	(1,520)	(331)
Net loans	$1,507,062	$985,187

Loans are primarily made in Eastern and Central North Carolina and in the Richmond and Tidewater area of Southeastern Virginia. Real estate loans can be affected by the condition of the local real estate market. Commercial and industrial loans and loans to individuals can be affected by the local economic conditions. Non-accrual loans, all of which are considered to be impaired, at December 31, 2007 and 2006 consisted of loans of approximately $3.4 million and $3.3 million, respectively, that were more than 90 days delinquent and on which the accrual of interest had ceased. The average recorded investment in non-accrual loans was approximately $2.1 million, $1.3 million and $252,000 for the years ended December 31, 2007, 2006 and 2005, respectively. Interest income that would have been recorded on non-accrual loans totaled $193,000, $70,000 and $141,000 for the years ended December 31, 2007, 2006 and 2005. The total amount of impaired loans as of December 31, 2007 and 2006 was $15.2 million and $4.1 million, respectively. The allowance for loan losses allocated to these impaired loans was $1.6 million and $902,000 at December 31, 2007 and 2006, respectively. There was no allowance for loan losses established for $4.9 million and $132,000 of the impaired loans at December 31, 2007 and 2006, respectively. Real estate owned aggregated $482,000 at December 31, 2007.

The Company grants loans to directors and executive officers of the Bank and their related interests. Such loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other borrowers and, in management's opinion, do not involve more than the normal risk of collectability. All loans to directors and executive officers or their related interests are submitted to the Board of Directors for approval.

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE D — LOANS (Continued)

A summary of related party loan transactions is as follows (in thousands):

	2007
Balance at beginning of year	$ 50,374
Additions	54,028
Loan repayments	(38,061)
Balance at end of year	$ 66,341

At December 31, 2007, commitments to extend credit to directors, executive officers and their related interests consisted of unused lines of credit totaling $13.5 million.

An analysis of the allowance for loan losses follows:

	2007	2006	2005
		(Dollars in thousands)	
Balance at beginning of year	$ 9,405	$ 6,283	$ 4,163
Provision charged to operations	4,900	3,400	2,200
Allowance acquired from The Bank of Richmond acquisition	2,122	—	—
Charge-offs	(1,155)	(305)	(87)
Recoveries	67	27	7
Net charge-offs	(1,088)	(278)	(80)
Balance at end of year	$ 15,339	$ 9,405	$ 6,283

NOTE E — PREMISES AND EQUIPMENT

Following is a summary of premises and equipment at December 31, 2007 and 2006:

	2007	2006
	(Dollars in thousands)	
Land	$ 8,374	$ 4,799
Furniture and equipment	12,308	9,692
Vehicles	1,039	763
Buildings and improvements	49,610	25,942
Construction in progress	10,800	3,135
Accumulated depreciation	(8,517)	(5,875)
Total	$ 73,614	$ 38,456

Depreciation and amortization amounting to $2.8 million, $2.4 million and $1.5 million for the years ended December 31, 2007, 2006 and 2005, respectively, is included in occupancy and equipment expense.

The Company leases, under separate agreements, land on which its operations facility and financial center facilities in Norfolk, Chesapeake and Virginia Beach, Virginia and Elizabeth City, Raleigh, Kitty Hawk and Nags Head, North Carolina are located. These leases expire at various dates through January 31, 2034. Future rentals under these leases are as follows (in thousands):

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE E — PREMISES AND EQUIPMENT (Continued)

2008	$ 1,574
2009	1,430
2010	1,307
2011	1,227
2012	1,122
Thereafter	12,350
	$ 19,010

Rental expense amounted to $2.0 million, $1.5 million and $819,000 during the years ended December 31, 2007, 2006 and 2005, respectively.

Certain leases contain options to extend for up to three consecutive five-year terms. The Company has an option to purchase the land on which its permanent headquarters are affixed at the end of the twenty-year lease term for a cost of $300,000.

Gateway Bank & Trust Co. leases its Nags Head and one of its Kitty Hawk branch offices from a director and his wife for monthly payments of approximately $6,000 and $16,272, respectively. The term of the Nags Head lease is for five years, with one five-year renewal. Kitty Hawk is a land lease that commenced in April 2006 for a term of twenty years, with three five-year renewals.

NOTE F — DEPOSITS

The weighted average cost of time deposits was 4.98%, 4.56% and 3.85% at December 31, 2007, 2006 and 2005, respectively.

Time deposits in denominations of $100,000 or more were $271.3 million and $205.5 million at December 31, 2007 and 2006, respectively. Interest expense on such deposits aggregated $20.9 million in 2007 and $10.2 million in 2006. At December 31, 2007, the scheduled maturities of time deposits are as follows (in thousands):

	$100,000 and Over	Under $100,000	Total
2008	$ 252,235	$ 571,061	$ 823,296
2009	4,035	16,593	20,628
2010	9,100	13,098	22,198
2011	1,889	3,659	5,548
2012	4,015	6,805	10,820
2013	—	21	21
Total	$ 271,274	$ 611,237	$ 882,511

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE G — BORROWINGS

A summary of the balances of borrowings follows:

	December 31, 2007	December 31, 2006
	(Dollars in thousands)	
Federal funds purchased	$ 28,000	$ —
Federal Home Loan Bank	5,000	14,500
Total short-term borrowings	$ 33,000	$ 14,500
Federal Home Loan Bank	$ 169,000	$ 101,500
Line of credit with a bank	4,000	—
Reverse repurchase agreements	20,000	20,000
Junior Subordinated Debentures	56,102	30,929
Total long-term borrowings	$ 249,102	$ 152,429

Advances from the Federal Home Loan Bank of Atlanta consisted of the following at December 31, 2007 and 2006, (in thousands):

Maturity	Interest Rate	2007	2006
		(Dollars in thousands)	
May 4, 2012	4.25%	$ 15,000	$ —
March 17, 2010	5.71%	1,500	1,500
November 10, 2010	5.43%	5,000	5,000
July 31, 2017	2.96%	7,500	—
August 7, 2017	2.88%	10,000	—
April 21, 2008	4.22%	5,000	5,000
April 25, 2012	4.85%	—	10,000
May 8, 2012	4.23%	10,000	—
September 17, 2012	3.78%	10,000	—
July 23, 2012	4.85%	—	10,000
September 19, 2012	3.80%	25,000	—
October 4, 2011	4.35%	—	20,000
October 24, 2011	4.35%	—	5,000
August 8, 2011	4.56%	—	35,000
November 23, 2007	5.50%	—	14,500
September 1, 2011	4.49%	—	10,000
September 27, 2012	3.72%	20,000	—
October 22, 2012	3.65%	25,000	—
July 25, 2012	4.53%	15,000	—
July 31, 2012	4.17%	7,500	—
August 28, 2012	3.99%	10,000	—
December 12, 2012	2.95%	7,500	—
		$ 174,000	$ 116,000

All of the above advances from the Federal Home Loan Bank are callable with the exception of the $5.0 million that is maturing on April 21, 2008. All of the advances are at fixed rates with the exception of the advances that mature on October 22, 2012, July 31, 2017 and August 7, 2017. Pursuant to collateral agreements with the Federal

NOTE G — BORROWINGS (Continued)

Home Loan Bank, at December 31, 2007 advances are secured by investment securities available for sale with a fair value of $44.6 million and by loans with a carrying amount of $274.4 million, which approximates market value. The Company has a maximum borrowing amount of $432.1 million as of December 31, 2007.

The Company may purchase federal funds through six unsecured federal funds lines of credit aggregating $106.5 million. These lines are intended for short-term borrowings and are subject to restrictions limiting the frequency and term of advances. These lines of credit are payable on demand and bear interest based upon the daily federal funds rate (4.25% at December 31, 2007). The Company had $28.0 million and $0 outstanding on these lines of credit as of December 31, 2007 and 2006, respectively. The maximum amounts outstanding under these lines of credit at any month-end during 2007 and 2006 were $28.0 million and $35.0 million, respectively. The average amounts outstanding under these lines of credit were $12.8 million for 2007 and $11.0 million for 2006.

The Company entered into two reverse repurchase agreements in 2006 pursuant to a master repurchase agreement. Each repurchase agreement is for $10.0 million, and is collateralized with mortgage backed securities with a similar fair market value. The first repurchase agreement, dated August 1, 2006 has a five year term. The interest rate on this agreement was 4.49% from August 1, 2006 through November 1, 2006. The interest rate was fixed at 4.99% on November 1, 2006 until it is repurchased by the counterparty on August 1, 2011. The agreement is callable by the counterparty on a quarterly basis. The second repurchase agreement, dated August 1, 2006 has a seven year term with a repurchase date of August 1, 2013. The interest rate of this agreement was 4.55% from August 1, 2006 through February 1, 2007, at which time it adjusted to a variable rate of 9.85% minus three month LIBOR (4.91% at December 31, 2007), not to exceed 5.85%, for the duration of the contract. The applicable interest rate in effect at December 31, 2007 was 4.94%. The agreement is callable by the counterparty on a quarterly basis.

In August of 2003, $8.0 million of trust preferred securities were placed through Gateway Capital Statutory Trust I (the "Trust"). The Trust issuer has invested the total proceeds from the sale of the Trust Preferred in Junior Subordinated Deferrable Interest Debentures (the "Junior Subordinated Debentures") issued by the Company. The trust preferred securities pay cumulative cash distributions quarterly at an annual rate, reset quarterly, equal to LIBOR plus 3.10%. The dividends paid to holders of the trust preferred securities, which are recorded as interest expense, are deductible for income tax purposes. The trust preferred securities are redeemable on or after September 17, 2008, in whole or in part. Redemption is mandatory at September 17, 2033. The Company has fully and unconditionally guaranteed the trust preferred securities through the combined operation of the debentures and other related documents. The Company’s obligation under the guarantee is unsecured and subordinate to senior and subordinated indebtedness of the Company.

In June of 2004, $7.0 million of trust preferred securities were placed through Gateway Capital Statutory Trust II (the "Trust"). The Trust issuer has invested the total proceeds from the sale of the Trust Preferred Securities in Junior Subordinated Deferrable Interest Debentures (the "Junior Subordinated Debentures") issued by the Company. The trust preferred securities pay cumulative cash distributions quarterly at an annual rate, reset quarterly, equal to the 3 month LIBOR plus 2.65%. The dividends paid to holders of the trust preferred securities, which are recorded as interest expense, are deductible for income tax purposes. The trust preferred securities are redeemable on or after June 17, 2009, in whole or in part. Redemption is mandatory at June 17, 2034. The Company has fully and unconditionally guaranteed the trust preferred securities through the combined operation of the debentures and other related documents. The Company’s obligation under the guarantee is unsecured and subordinate to senior and subordinated indebtedness of the Company.

In May of 2006, $15.0 million of trust preferred securities were placed through Gateway Capital Statutory Trust III (the "Trust"). The Trust issuer has invested the total proceeds from the sale of the Trust Preferred Securities in Junior Subordinated Deferrable Interest Debentures (the "Junior Subordinated Debentures") issued by the Company. The trust preferred securities pay cumulative cash distributions quarterly at an annual rate, reset quarterly, equal to the 3 month LIBOR plus 1.50%. The dividends paid to holders of the trust preferred securities, which are recorded as interest expense, are deductible for income tax purposes. The trust preferred securities are redeemable on or after May 30, 2011, in whole or in part. Redemption is mandatory at May 30, 2036. The Company has fully and

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE G — BORROWINGS (Continued)

unconditionally guaranteed the trust preferred securities through the combined operation of the debentures and other related documents. The Company's obligation under the guarantee is unsecured and subordinate to senior and subordinated indebtedness of the Company.

In May of 2007, $25.0 million of trust preferred securities were placed through Gateway Capital Statutory Trust IV (the "Trust"). The Trust issuer has invested the total proceeds from the sale of the Trust Preferred Securities in Junior Subordinated Deferrable Interest Debentures (the "Junior Subordinated Debentures") issued by the Company. The trust preferred securities pay cumulative cash distributions quarterly at an annual rate, reset quarterly, equal to the 3 month LIBOR plus 1.55%. The dividends paid to holders of the trust preferred securities, which are recorded as interest expense, are deductible for income tax purposes. The trust preferred securities are redeemable on or after July 30, 2012, in whole or in part. Redemption is mandatory at July 30, 2037. The Company has fully and unconditionally guaranteed the trust preferred securities through the combined operation of the debentures and other related documents. The Company's obligation under the guarantee is unsecured and subordinate to senior and subordinated indebtedness of the Company.

The trust preferred securities presently qualify as Tier 1 regulatory capital and are reported in Federal Reserve regulatory reports as a minority interest in a consolidated subsidiary. The junior subordinated debentures do not qualify as Tier 1 regulatory capital. On March 1, 2005, the Board of Governors of the Federal Reserve issued a final rule stating that trust preferred securities will continue to be included in Tier 1 capital, subject to stricter quantitative and qualitative standards. For Bank Holding Companies, after a transition period, under the new rule which is effective as of March 31, 2009, trust preferred securities will continue to be included in Tier 1 capital up to 25% of core capital elements (including trust preferred securities) net of goodwill less any associated deferred tax liability. As of December 31, 2007 the Company has $408,000 of the trust preferred securities that did not qualify for Tier 1 capital and was included in Tier 2 capital.

In March 2007, the Company entered into a three year, $20,000,000 revolving line of credit agreement with a bank. Interest on the outstanding principal is based on 90 day LIBOR plus 1.25%, giving an interest rate of 6.57% at December 31, 2007. At December 31, 2007 the Company had $4,000,000 outstanding on the line of credit. The agreement requires that the Company must maintain certain financial ratios and remain well capitalized per regulatory guidelines. The Company was in compliance with all financial covenants as of December 31, 2007.

NOTE H — INCOME TAXES

The significant components of the provision for income taxes for the years ended December 31, 2007, 2006 and 2005.

	2007	2006	2005
		(In thousands)	
Current tax provision:			
Federal	$ 5,302	$ 3,373	$ 1,841
State	958	571	309
	6,260	3,944	2,150
Deferred tax provision:			
Federal	(233)	(1,130)	(181)
State	(37)	(189)	(4)
	(270)	(1,319)	(185)
Net provision for income taxes	$ 5,990	$ 2,625	$ 1,965

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE H — INCOME TAXES (Continued)

The difference between the provision for income taxes and the amounts computed by applying the statutory federal income tax rate of 35% to income before income taxes is summarized below:

	2007	2006	2005
		(In thousands)	
Tax computed at the statutory federal rate	$ 5,953	$ 2,684	$ 2,007
Increase (decrease) resulting from:			
State income taxes, net of federal benefit	599	253	184
Non-taxable interest income	(123)	(65)	(59)
Non-taxable income from bank owned life insurance	(369)	(294)	(231)
Other permanent differences	(70)	47	64
Provision for income taxes	$ 5,990	$ 2,625	$ 1,965

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of deferred taxes at December 31, 2007 and 2006 are as follows:

	2007	2006
	(In thousands)	
Deferred tax assets relating to:		
Allowance for loan losses	$ 5,816	$ 3,464
Equity investment basis difference	—	6
Unrealized loss on economic hedge	—	460
Unrealized loss on securities available for sale	649	462
Deferred and stock based compensation	529	—
Fair value adjustment to net assets acquired in business combination	275	—
Other	256	187
Total deferred tax assets	7,525	4,579
Deferred tax liabilities relating to:		
Premises and equipment	(743)	(545)
Deferred loan costs	(1,017)	(709)
Intangible assets	(1,697)	(1,026)
Unrealized fair value gains on trust preferred securities	(230)	—
Prepaid expenses	(262)	(248)
Total deferred tax liabilities	(3,949)	(2,528)
Net recorded deferred tax assets	$ 3,576	$ 2,051

It is management's opinion that realization of the net deferred tax asset is more likely than not based on the Company's history of taxable income and estimates of future taxable income.

The adoption of FIN 48 did not have a material effect on our consolidated financial position or results of operations and unrecognized tax benefits as of December 31, 2007, and 2006. The balance of unrecognized tax benefits were immaterial at December 31, 2007 and 2006. The Company classifies interest and penalties related to income tax assessments, if any, in income tax expense in the consolidated statement of operations and interest and penalties recognized in 2007, 2006, and 2005 were immaterial. Fiscal years ending on or after December 31, 2003 are subject to examination by federal and state tax authorities.

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE I — OTHER NON-INTEREST EXPENSE

The major components of other non-interest expense for the years ended December 31, 2007, 2006 and 2005 are as follows:

	2007	2006	2005
		(Dollars in thousands)	
Professional services	$ 1,374	$ 1,535	$ 1,399
Postage, printing and office supplies	1,848	1,504	1,355
Advertising and promotion	770	1,814	541
Amortization of intangibles	558	323	380
FDIC Assessment	780	92	57
Franchise Taxes	895	690	183
Other	3,494	3,212	2,235
Total	$ 9,719	$ 9,170	$ 6,150

NOTE J — REGULATORY MATTERS

The Company is subject to various regulatory capital requirements administered by federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios, as set forth in the table below. Management believes, as of December 31, 2007, that the Company meets all capital adequacy requirements to which it is subject. At December 31, 2007, the Company's total risk-based capital, Tier I risk-based capital, and leverage ratios were 11.40%, 10.43% and 9.76%, respectively.

As of December 31, 2007, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum amounts and ratios, as set forth in the table below. There are no conditions or events since that notification that management believes have changed the Bank's category. The Bank's actual capital amounts and ratios are also presented in the table below:

	Actual		Minimum for Capital Adequacy Purposes		Minimum to be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in thousands)			
As of December 31, 2007:						
Total Capital (to Risk-Weighted Assets)	$180,479	11.19%	$129,033	8.00%	$161,291	10.00%
Tier I Capital (to Risk-Weighted Assets)	165,139	10.24%	64,517	4.00%	96,775	6.00%
Tier I Capital (to Average Assets)	165,139	9.46%	69,844	4.00%	87,305	5.00%
As of December 31, 2006:						
Total Capital (to Risk-Weighted Assets)	$130,191	12.28%	$ 84,814	8.00%	$106,018	10.00%
Tier I Capital (to Risk-Weighted Assets)	120,786	11.39%	42,407	4.00%	63,611	6.00%
Tier I Capital (to Average Assets)	120,786	10.62%	45,929	4.00%	57,411	5.00%

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE J — REGULATORY MATTERS (CONTINUED)

The Bank may not declare or pay a cash dividend, or repurchase any of its capital stock, if the effect would cause the regulatory net worth of the Bank to fall to an amount which is less than the minimum required by the FDIC and the North Carolina Office of the Commissioner of Banks.

NOTE K — OFF-BALANCE SHEET RISK

The Company is a 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 and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial 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 to a customer as long as there is no violation of conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to 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 Bank, upon extension of credit is based on management’s credit evaluation of the borrower. Collateral obtained varies but may include real estate, stocks, bonds, and certificates of deposit.

A summary of the contract amount of the Company’s exposure to off-balance sheet risk as of December 31, 2007 is as follows (in thousands):

Financial instruments whose contract amounts represent credit risk:	
Commitments to extend credit	$ 17,500
Undisbursed lines of credit	444,404
Standby letters of credit	19,411
Commitments to originate mortgage loans, Fixed and variable rate	12,181

NOTE L — FAIR VALUE MEASUREMENT AND DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS

Effective January 1, 2007, the Company elected early adoption of Statements of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements" and SFAS No. 159 "The Fair Value Option for Financial Assets and Liabilities". SFAS No. 157, which was issued in September 2006, establishes a framework for using fair value. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 159, which was issued in February 2007, generally permits the measurement of selected eligible financial instruments at fair value at specified election dates. Upon adoption of SFAS No. 159, the Company selected the fair value measurement option for various pre-existing financial assets and liabilities, including certain short-term investment securities used primarily for liquidity and asset liability management purposes in the available for sale portfolio totaling approximately $51.0 million; and junior subordinated debentures issued to unconsolidated capital trusts of $15.5 million. The initial fair value measurement of these items resulted in, approximately, a $1.2 million cumulative-effect adjustment, net of tax, recorded as a reduction in retained earnings as of January 1, 2007. Under SFAS No. 159, this one-time charge was not recognized in current earnings.

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE L — FAIR VALUE MEASUREMENT AND DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

The investment securities selected for fair value measurement are classified as trading securities because they are held principally for resale in the near term and are reported at fair value in the consolidated balance sheet at December 31, 2007. Interest and dividends are included in net interest income. Unrealized gains and losses are reported as a component in non-interest income. The Company recorded trading gains of approximately $355,000 for the year ended December 31, 2007. Additionally, the Company recorded income of $960,000 related to the change in fair value of the junior subordinated debentures during the year ended December 31, 2007, which was also recorded as a component of non-interest income. The Company chose to elect fair value measurement for these specific assets and liabilities because they will have a positive impact on the Company's ability to manage the market and interest rate risks and liquidity associated with certain financial instruments (primarily investments with short durations and low market volatility); improve its financial reporting; mitigate volatility in reported earnings without having to apply complex hedge accounting rules; and remain competitive in the marketplace. The Company chose not to elect fair value measurement for municipal securities, corporate equity securities and bonds, longer term duration mortgage-backed securities, and held to maturity investments.

Below is a table that presents the cumulative — effect adjustment to retained earnings for the initial adoption of the fair value option (FVO) for the elected financial assets and liabilities as of January 1, 2007:

Description	Balance Sheet 1/1/07 prior to adoption	Net Gain/ (Loss) upon adoption	Balance Sheet 1/1/07 after adoption of FVO
	(Dollars in Thousands)		
Trading securities	$ —	$ —	$ 51,012
Accumulated other comprehensive loss	917	(917)	—
Junior subordinated debenture	(15,465)	(447)	(15,912)
Pretax cumulative effect of adoption of the fair value option	—	(1,364)	—
Decrease in deferred tax asset	—	167	—
Cumulative effect of adoption of the fair value option (charge to retained earnings)		$ (1,197)	

In accordance with SFAS No. 157, we group our financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. The most significant instruments that the Company fair values include securities, derivative instruments, and certain junior subordinated debentures. The majority of instruments fall into the Level 1 or 2 fair value hierarchy. Valuation methodologies for the fair value hierarchy are as follows:

Level 1 — Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 securities include common stock of publicly traded companies, and were valued based on the price of the security at the close of business on December 31, 2007.

Level 2 — Valuations are obtained from readily available pricing sources via independent providers for market transactions involving similar assets or liabilities. The company's principal market for these securities is the secondary institutional markets and valuations are based on observable market data in those markets. Level 2 securities include U. S. Treasury, other U.S. government and agency mortgage-backed securities, corporate and municipal bonds, and preferred stock in U.S. government sponsored agencies.

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE L — FAIR VALUE MEASUREMENT AND DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

Level 3 — Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities. Level 3 financial instruments include economic hedges and junior subordinated debentures. The Company obtains pricing for these instruments from third parties who have experience in valuing these type of securities.

The Company measures or monitors certain of its assets and liabilities on a fair value basis. Fair value is used on a recurring basis for those assets and liabilities that were elected under SFAS No. 159 as well as for certain assets and liabilities in which fair value is the primary basis of accounting.

Below is a table that presents information about certain assets and liabilities measured at fair value on a recurring basis:

			Fair Value Measurements at December 31, 2007, Using			Changes in Fair Values for the 12 Month Period Ended December 31, 2007 for Items Measured at air Value Pursuant to Election of the Fair Value Option				
Description	Total Carrying Amount in The Consolidated Balance Sheet 12/31//07	Assets/Liabilities Measured at Fair Value 12/31/2007	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Trading Gains and Losses	Other Gains and Losses	Interest Income on Loans	Consolidated Expense on Long-term Debt	Total Changes in Fair Value Included in Current Period Earnings
Trading securities	$ 23,011	$ 23,011	$ —	$ 23,011	$ —	$ 355	$ —	$ —	$ —	$ 355
Available- for-sale securities	126,750	126,750	5,127	121,623	—	—		—	—	—
Junior subordinated debentures	56,102	14,865	—	—	14,865		960	—	—	960
Economic hedge liability	—	—	—	—	—	—	1,225	—	—	1,225

The Company evaluates other assets and liabilities for which fair value accounting is used on a non-recurring basis. These assets and liabilities include goodwill, loans held for sale, and real estate owned of $46.0 million, $5.6 million, and $482,000, respectively, at December 31, 2007. There were no fair value adjustments related to these assets and liabilities for the year ended December 31, 2007.

Junior subordinated debentures are included in long-term borrowings in the consolidated balance sheet as of December 31, 2007. Approximately $41.2 million of other junior subordinated debentures, $169.0 million of FHLB advances, $20.0 million of reverse repurchase agreements, and $4.0 million borrowed on a line of credit are included in long-term borrowings that were not elected for the fair value option.

The $12.8 million of various accrued expenses and liabilities presented on the companying consolidated balance sheet are not eligible for the fair value option.

Additionally, the Bank has other financial instruments that include cash and due from banks, interest-earning deposits with banks, loans, stock in the Federal Reserve Bank and the Federal Home Loan Bank of Atlanta, deposit accounts and borrowings. Fair value estimates for these financial instruments are made at a specific moment in time, based on relevant market information and information about the financial instrument using the same level hierarchy assumptions discussed above. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

NOTE L — FAIR VALUE MEASUREMENT AND DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

Cash and Due from Banks and Interest-Earning Deposits in Other Banks

The carrying amounts for cash and due from banks and interest-earning deposits in other banks approximate fair value because of the short maturities of those instruments.

Investment Securities

Fair value for investment securities equals quoted market price if such information is available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Loans

For certain homogenous categories of loans, such as residential mortgages, fair value is estimated using the quoted market prices for securities backed by similar loans, adjusted for differences in loan characteristics. The fair value of other types of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. The carrying amount of loans held for sale is a reasonable estimate of fair value since they will be sold in a short period.

Accrued Interest

The carrying amounts of accrued interest approximate fair value.

Stock in Federal Reserve Bank and Federal Home Loan Bank of Atlanta

The fair value for FRB and FHLB stock approximates carrying value, based on the redemption provisions of the Federal Reserve Bank and Federal Home Loan Bank.

Bank Owned Life Insurance

The carrying value of life insurance approximates fair value because this investment is carried at cash surrender value, as determined by the insurer.

Deposits

The fair value of demand, savings, money market and NOW account deposits is the amount payable on demand at the reporting date. The fair value of time deposits is estimated based on discounting expected cash flows using the rates currently offered for instruments of similar remaining maturities.

Borrowings

The fair values are based on discounting expected cash flows at the interest rate for debt with the same or similar remaining maturities and collateral requirements.

Financial Instruments with Off-Balance Sheet Risk

With regard to financial instruments with off-balance sheet risk discussed in Note K, it is not practicable to estimate the fair value of future financing commitments.

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE L — FAIR VALUE MEASUREMENT AND DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

The carrying amounts and estimated fair values of the Company's financial instruments are as follows at December 31, 2007 and 2006:

	2007		2006	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(In thousands)			
Financial assets:				
Cash and due from banks	$ 19,569	$ 19,569	$ 22,077	$ 22,077
Interest-earning deposits in other banks	1,092	1,092	4,717	4,717
Trading securities	23,011	23,011	—	—
Investment securities available for sale	126,750	126,750	93,475	93,475
Accrued interest receivable	12,330	12,330	8,742	8,742
Federal Reserve Bank stock	5,348	5,348	3,609	3,609
Federal Home Loan Bank stock	10,312	10,312	6,970	6,970
Loans	1,522,401	1,533,000	994,592	989,650
Bank owned life insurance	26,105	26,105	25,051	25,051
Financial liabilities:				
Deposits	1,408,919	1,410,000	923,725	931,413
Borrowings	282,102	280,500	166,929	167,846
Accrued interest payable	7,537	7,537	2,569	2,569

NOTE M — EMPLOYEE AND DIRECTOR BENEFIT PLANS

401(k) Retirement Plan

The Company has a 401(k) retirement plan that contains provisions for specified matching contributions by the Bank. The Company funds contributions as they accrue. Total 401(k) expense was $737,000, $520,000 and $388,000 during the years ended December 31, 2007, 2006 and 2005, respectively.

Stock Based Compensation

During 1999 the Company adopted, with shareholder approval, an Incentive Stock Option Plan (the "Employee Plan") and a Nonstatutory Stock Option Plan (the "1999 Director Plan"). During 2001 the Company increased, with shareholder approval, the number of shares available under its option plans. In 2002, the Company increased, with shareholder approval, the number of shares available under the Employee Plan. The Company also adopted a 2001 Nonstatutory Stock Option Plan. On November 24, 2004, the Company adopted a 2005 Omnibus Stock Ownership And Long Term Incentive Plan (the "Omnibus Plan") providing for the issuance of up to 726,000 shares of common stock under the terms of the Omnibus Plan, approved by the shareholders at the annual shareholder meeting. All options granted prior to November 2004 to non-employee directors vested immediately at the time of grant, while other options from this pool vest over a four-year period with 20% vesting on the grant date and 20% vesting annually thereafter. Options granted from the pool of shares made available on November 24, 2004 to non-employee directors vested immediately at the time of the grant, while options from this pool granted to employees vested 50% at the time of the grant and 50% the following year. During the year ended December 31, 2006 the Company granted 166,500 nonstatutory options which will vest at 20% per year beginning the month following the quarter in which the Company achieves a ROA of 1%. For purposes of the ROA calculation, the gain or loss from the fair market value of the economic hedge are excluded. During the year ended December 31, 2007 the Company granted 10,500 nonstatutory options with the same vesting criteria as in 2006.

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE M — EMPLOYEE AND DIRECTOR BENEFIT PLANS (Continued)

Stock Based Compensation (Continued)

The Company assumed as a result of the acquisition of The Bank of Richmond, the 1999 BOR Stock Option Plan, which was adopted by the Board of Directors of The Bank of Richmond as of June 2, 1999. The plan provides for the issuance of up to 601,237 shares of common stock of which 369,048 were outstanding and fully vested as of December 31, 2007.

All unexercised options expire ten years after the date of grant. All references to options have been adjusted to reflect the effects of stock splits. The exercise price of all options granted to date under these plans range from $3.95 to $16.53. At December 31, 2007 the number of shares available for grant under Omnibus plan was 644,678.

The fair market value of each option award is estimated on the date of grant using the Black-Scholes option pricing model. The Company has assumed a volatility rate of 14.2% to 17.1%, an expected life of 7 years, interest rate of 4.37% and a dividend yield of 1.50% in the Black Scholes computation related to the options granted in 2007. The Company granted 10,500 nonqualifying stock options during the year ended December 31, 2007; and the Company granted 166,500 nonqualifying stock options during the year ended December 31, 2006. During the twelve months ended December 31, 2005, the Company granted 162,250 options.

A summary of the Company's option plans as of and for the years ended December 31, 2007, 2006 and 2005 is as follows:

			Outstanding Options		Exercisable Options	
	Shares in Plans	Shares Available for Future Grants	Number Outstanding	Weighted Average Exercise Price	Number Outstanding	Weighted Average Exercise Price
At December 31, 2004	1,380,973	8,195	1,372,778	$ 9.31	1,187,621	$ 9.04
Options authorized			726,000	726,000	—	—
Options granted/vested	—	(162,250)	162,250	16.05	335,199	16.02
Options exercised	(163,156)	—	(163,156)	7.50	(163,156)	7.50
Options forfeited	—	10,890	(10,890)	11.72	(10,890)	11.72
At December 31, 2005	1,943,817	582,835	1,360,982	10.31	1,348,774	10.33
Options authorized			—	—	—	—
Options granted/vested	—	(166,500)	166,500	14.62	9,031	8.47
Options exercised	(13,897)	—	(13,897)	7.36	(13,897)	7.36
Options forfeited	—	3,888	(3,888)	9.39	(3,888)	9.39
At December 31, 2006	1,929,920	420,223	1,509,697	10.82	1,340,020	10.35
Options authorized	—	—	—	—	—	—
Options granted/vested	—	(10,500)	10,500	14.06	3,005	14.06
Options exercised	(14,493)	—	(14,493)	7.72	(14,493)	7.72
Options forfeited	—	8,505	(8,505)	14.62	(5)	6.35
Assumed in The Bank Of Richmond acquisition	601,237	226,450	374,787	4.56	374,787	4.56
At December 31, 2007	2,516,664	644,678	1,871,986	$ 9.59	1,703,314	$ 9.10

NOTE M — EMPLOYEE AND DIRECTOR BENEFIT PLANS (Continued)

Stock Based Compensation (Continued)

Outstanding options include 1,871,986 options with exercise prices ranging from $3.95 to $16.53 per share, of which 1,703,314 are exercisable at December 31, 2007. The weighted average remaining life of total options outstanding and options exercisable as of December 31, 2007 is 4.80 years and 4.41 years, respectively. The weighted average fair value of options granted in 2007, 2006 and 2005 was $3.71, $3.68 and $4.90, respectively, and was determined as of the date of grant using the Black-Scholes option pricing model, assuming a dividend growth rate ranging from 0% to 5% for each period; expected volatility of 14.33%, 16.42% and 24.26%; risk-free interest rates ranging from 3.9% to 4.78%; and expected lives of 7 years for new grants during the years ended December 31, 2007, 2006 and 2005, respectively.

For the year ended December 31, 2007, the intrinsic value of options exercised and fair value of options vested amounted to $104,079 and $10,146, respectively. The aggregate intrinsic value of options outstanding at December 31, 2007 amounted to $6.2 million. The aggregate intrinsic value of options exercisable at December 31, 2007 amounted to $6.2 million. For the year ended December 31, 2006, the intrinsic value of options exercised and fair value of options vested amounted to $103,254 and $133,568, respectively. The aggregate intrinsic value of options outstanding and exercisable at December 31, 2006 amounted to $5.9 million and $5.2 million, respectively.

Cash received from option exercises under all share-based payment arrangements for the year ended December 31, 2007 was $116,000. The actual tax benefit realized for tax deductions from option exercise of the share-based payment arrangements totaled $43,000 for the year ended December 31, 2007.

A summary of restricted stock outstanding (split adjusted) during the year is presented below:

	Shares	Weighted Average Grant Date Fair Value
Non-vested outstanding at December 31, 2006	13,750	$ 15.26
Granted	62,500	14.59
Vested	(13,750)	15.26
Forfeited	(1,000)	14.62
Non-vested outstanding at December 31, 2007	61,500	$ 14.60

The total fair value of restricted stock grants issued during the year ended December 31, 2007 was $912,200. The fair value of restricted stock grants vested during the period was $209,800.

As of December 31, 2007, there was approximately $1.1 million of unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the plans. That cost is expected to be recognized over a weighted average period of 2.64 years.

The adoption of SFAS 123R and its fair market value cost recognition provisions are different from the provisions used SFAS 123 and the intrinsic value method for compensation cost allowed under APB 25. The effect (increase (decrease)) of the adoption of 123R is presented below:

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE M — EMPLOYEE AND DIRECTOR BENEFIT PLANS (Continued)

Stock Based Compensation (Continued)

	2005 (Amounts in thousands, except per share data)
Net income:	
As reported	$ 3,939
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects	1,748
Pro forma	$ 2,191
Basic net income per share:	
As reported	$ 0.48
Pro forma	0.27
Diluted net income per share:	
As reported	$ 0.46
Pro forma	0.26

For purposes of this pro-forma disclosure, the value of the options is estimated using the Black-Scholes option pricing model and amortized to expense over the options' vesting periods.

Employment Contracts

The Company has entered into employment agreements with its chief executive officer and seventeen other officers to ensure a stable and competent management base. The agreements provide for a three-year term, but the agreements may be extended for an additional year at the end of the first year and annually thereafter. The agreements provide for benefits as spelled out in the contracts and cannot be terminated by the Board of Directors, except for cause, without prejudicing the officers' rights to receive certain vested rights, including compensation. In the event of a change in control of the Bank and in certain other events, as defined in the agreements, the Bank or any successor to the Company will be bound to the terms of the contracts.

Salary Continuation Agreements

The Company in October 2006 entered into Salary Continuation Agreements with its chief executive officer and one other executive officer. These Salary Continuation Agreements provide for benefits to be paid for 15 years to each executive with the payment amounts varying upon different retirement scenarios, such as normal retirement, early termination, disability, or change in control. The Company has purchased life insurance policies on the participating officers in order to offset the future funding of benefit payments. Provisions of $406,672 and $85,628 were provided for the years ended December 31, 2007 and 2006, respectively, for future benefits to be provided under these plans. The corresponding liability related to this plan was $492,300 and $85,268 as of December 31, 2007 and 2006, respectively.

The Company also has a deferred compensation plan for its directors. Expense provided under the plan totaled $267,000, $175,000 and $106,400 for the years ended December 31, 2007, 2006 and 2005, respectively. Since 2003, directors have had the option to invest amounts deferred in Company common stock that is held in a rabbi trust established for that purpose. At December 31, 2007 and 2006, the trust held 51,513 and 31,984 shares of Company common stock, respectively.

NOTE N — ACQUISITIONS

The Bank of Richmond Transaction

On June 1, 2007, the Company completed the acquisition of The Bank of Richmond, a Richmond, Virginia based bank with approximately $197.0 million in assets, operating 6 financial centers in the Richmond area and a loan production office in Charlottesville, Virginia. The Bank of Richmond acquisition further enhances the Company's geographic footprint and provides a meaningful presence in the demographically attractive Richmond market.

Pursuant to the terms of the acquisition, the Company purchased 100% of the outstanding stock of The Bank of Richmond with a combination of cash and stock of the Company. The aggregate purchase price was $56.6 million including approximately $1.1 million of transaction costs. The Company issued approximately 1.85 million shares of the Company's common stock, assumed outstanding Bank of Richmond stock options valued at approximately $3.6 million, and paid approximately $25.6 million in cash to The Bank of Richmond shareholders for the approximate 1.72 million shares of The Bank of Richmond shares outstanding. The overall exchange for stock was limited to 50% of The Bank of Richmond common stock, using an exchange ratio of 2.11174 of the Company stock for every share of The Bank of Richmond stock. The value of the common stock exchanged was determined based on the average market price of the Company's common stock over the 10-day period ended May 21, 2007.

The acquisition transaction has been accounted for using the purchase method of accounting for business combinations, and accordingly, the assets and liabilities of The Bank of Richmond were recorded based on estimated fair values as of June 1, 2007, with the estimate of goodwill being subject to possible adjustments during the one-year period from that date. Goodwill will not be amortized but will be tested for impairment in accordance with SFAS No. 142. None of the goodwill is expected to be deductible for income tax purposes. The consolidated financial statements include the results of operations of The Bank of Richmond since June 1, 2007.

The estimated fair values of the The Bank of Richmond assets acquired and liabilities assumed at the date of acquisition based on the information currently available is as follows (in thousands):

Cash and cash equivalents	$ 17,974
Investment securities, available for sale	2,998
Loans, net	165,879
Premises and equipment, net	8,749
Goodwill	36,699
Core deposit intangible	1,464
Other assets	1,927
Deposits	(177,572)
Borrowings	(50)
Other liabilities	(1,566)
Stockholders' Equity	98
Net assets acquired	$ 56,600

Goodwill is lower while other assets and other liabilities are higher than originally reported at June 30, 2007 by $487,000, $246,000, and $405,000, respectively, primarily as a result of adjustments made for deferred income taxes and transactions cost. These adjustments result in a net assets acquired increase of $164,000 from what was originally reported at June 30, 2007. The core deposit intangible will be amortized on the straight-line basis over a ten-year life. The amortization method and valuation of the core deposit intangible are based upon a historical study of the deposits acquired. Discounts totaling $960,000 and $68,000 that resulted from recording The Bank of Richmond assets and liabilities at their respective fair values are being accreted using methods that approximate an effective yield over the life of the assets and liabilities. The net accretion increased net income before taxes by $56,000 for the year ended December 31, 2007.

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE N — ACQUISITIONS (Continued)

The following unaudited pro forma financial information presents the combined results of operations of the Company and The Bank of Richmond as if the acquisition had occurred as of the beginning of the period for each period presented, after giving effect to certain adjustments, including amortization of the core deposit intangible, fair value premium and discounts, and additional financing necessary to complete the transaction.

	2007	2006	2005
		(Dollars in thousands)	
Net interest income	$ 51,739	$ 42,951	$ 27,781
Non-interest income	18,223	9,872	8,746
Total revenue	69,962	52,823	36,527
Provision for loan losses	5,416	3,591	2,502
Acquisition related charges	2,286	—	—
Other non-interest expense	47,356	39,728	27,468
Income before taxes	14,904	9,504	6,557
Net income	9,439	6,368	4,441
Net income per common share:			
Basic	$ 0.74	$ 0.50	$ 0.44
Diluted	$ 0.72	$ 0.49	$ 0.42

Acquisition related charges in the above table represent one-time costs associated with the acquisition and integration of the operations of the Company and The Bank of Richmond, and do not represent ongoing costs of the fully integrated combined organization. These costs included change-of-control, severance, and other employee-related costs of $1.43 million, system integration costs of $175,000, professional, consulting, and investment banker costs of $647,000 and other costs of $38,000.

Other Acquisitions

During January 2007, the Bank completed the acquisition of Breen Title & Settlement, Inc., an independent title agency with offices located in Newport News, Hampton and Virginia Beach, Virginia. A summary, of the purchase price and the assets acquired is as follows:

	(Dollars in Thousands)
Purchase price:	
Portion paid in cash	$ 445
Issuance of common stock	425
Total purchase price	$ 870
Assets acquired:	
Property and equipment	$ 15
Goodwill	855
Total assets acquired	$ 870

It is anticipated that the goodwill related to the acquisition of Breen Title & Settlement, Inc. is tax deductible. The pro forma impact of the acquisition presented as though it had been made at the beginning of the period presented is not considered material to the Company's consolidated financial statements.

Table of Contents

NOTE N — ACQUISITIONS (Continued)

During October 2006, Gateway Insurance Services, Inc., completed the acquisition of Insurance Center, Inc., an independent insurance agency located in Chesapeake, Virginia. This transaction was accounted for as a purchase. A summary of the purchase price and the assets acquired is as follows.

	(Dollars in Thousands)
Purchase price:	
Issuance of common stock	$ 588
Total purchase price	$ 588
Assets acquired:	
Other intangibles	$ 588
Goodwill	226
Total assets acquired	$ 814
Liabilities Assumed:	
Deferred taxes	$ 226
Total liabilities assumed	$ 226

During December 2006, Gateway Insurance Services, Inc., completed the acquisition of C D West, III, Inc an independent insurance agency located in Newport News, Virginia. This transaction was accounted for as a purchase. A summary, in thousands, of the purchase price and the assets acquired is as follows.

	(Dollars in Thousands)
Purchase price:	
Issuance of common stock	$ 1,500
Total purchase price	$ 1,500
Assets acquired:	
Property and equipment	$ 36
Accounts receivable	75
Goodwill	770
Other intangibles	1,045
Total assets acquired	$ 1,926
Liabilities Assumed:	
Accounts payable	$ 34
Deferred taxes	392
Total liabilities assumed	$ 426

The goodwill related to the acquisition of C D West, III, Inc. and Insurance Center, Inc. is not tax deductible.

The pro-forma impact of the acquisitions of CD West III, Inc. and Insurance Center, Inc. as though they had been made at the beginning of the periods presented is not considered material to the Company's consolidated financial statements.

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE O — STOCKHOLDERS' EQUITY

Preferred Stock

On December 19, 2007 Gateway Financial Holdings, Inc. sold 23,266 shares of Class A Non-Cumulative Perpetual Preferred Stock with a liquidation value of $1,000 per share. Proceeds from the private placement, net of expenses, were $23.2 million. The shares of preferred stock were sold solely to accredited investors in a transaction that was exempt from registration pursuant to Section 4(2) and Rule 506 of Regulation D promulgated under the Securities Act of 1933, as amended.

The Company intends to pay quarterly non-cumulative cash dividends on the preferred stock at an annual rate of 8.75%. The Company may redeem all or a portion of the preferred stock at any time, and for any reason, after January 1, 2009.

The preferred stock is not convertible and has no general voting rights. All preferred stock outstanding has preference over the common stock with respect to the payment of dividends and distribution of assets in the event of liquidation or dissolution.

Common Stock

The Company's stock repurchase program, as approved by the Board of Directors on April 30, 2007, provides for the purchase of up to 500,000 shares. There have been 400,637 shares purchased under the 2007 plan during the year ended December 31, 2007.

The following table presents share repurchase activity for the year ended December 31, 2007, including total common shares repurchased under the announced program, weighted average per share price and the remaining buyback authority under announced programs.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Number of Shares That May Yet Be Purchased Under the Program (1)
April 1, 2007 to June 30, 2007	92,564	$ 14.71	92,564	407,436
July 1, 2007 to September 30, 2007	207,436	14.47	300,000	200,000
October 1, 2007 to December 31, 2007	100,637	12.33	400,637	99,363
Total	400,637	$ 13.98	400,637	99,363

Table of Contents

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE P — PARENT COMPANY FINANCIAL DATA

Gateway Financial Holdings, Inc. became the holding company for Gateway Bank & Trust Co. effective October 1, 2001. Following are condensed financial statements of Gateway Financial Holdings, Inc. as of December 31, 2007 and 2006 and for the years ended December 31, 2007, 2006 and 2005, presented in thousands.

Condensed Balance Sheets
December 31, 2007 and 2006

	2007	2006
Asset:		
Cash on deposit in subsidiary	$ 4,357	$ 1,679
Investment in securities available for sale	4,916	7,266
Investment in subsidiaries	215,652	131,653
Other assets	991	192
Total assets	$ 225,916	$ 140,790
Liabilities:		
Long term borrowings	$ 60,102	$ 30,929
Other liabilities	1,407	221
Total liabilities	61,509	31,150
Stockholders' equity:		
Preferred stock	23,182	—
Common stock	127,258	101,669
Retained earnings	14,991	8,708
Accumulated other comprehensive loss	(1,024)	(737)
Total stockholders' equity	164,407	109,640
Total liabilities and stockholders' equity	$ 225,916	$ 140,790

Condensed Statements of Operations
Years Ended December 31, 2007, 2006 and 2005

	2007	2006	2005
Equity in income of subsidiary	$ 13,453	$ 6,499	$ 4,716
Interest and dividend income	82	34	18
Other Income	960	—	—
Gain on sale of securities	—	653	199
Interest expense	(3,474)	(1,831)	(939)
Other expense	(2)	(86)	(55)
	$ 11,019	$ 5,269	$ 3,939

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE P — PARENT COMPANY FINANCIAL DATA (Continued)

Condensed Statements of Cash Flows
Years Ended December 31, 2007, 2006 and 2005

	2007	2006	2005
Operating activities:			
Net income	$ 11,019	$ 5,269	$ 3,939
Equity in income of subsidiary	(13,453)	(6,499)	(4,716)
Amortization of debt issuance costs	—	55	55
Realized gain on sale of available-for-sale securities	—	(653)	(199)
Realized gain on fair value on junior subordinated debt	(960)	—	—
Deferred and stock based compensation	380	222	90
(Increase) decrease in other assets	(54)	392	(482)
Increase in other liabilities	1,341	25	6
	(1,727)	(1,189)	(1,307)
Investing activities:			
Purchases of available-for-sale securities	(244)	(6,619)	(5,102)
Investment in subsidiaries	(46,260)	(23,464)	(30,000)
Proceeds from the sale of securities	—	5,459	766
Upstream dividend received from the Bank	6,500	4,500	—
	(40,004)	(20,124)	(34,336)
Financing activities:			
Proceeds from issuance of junior subordinated debentures	25,774	15,464	—
Proceeds from long term borrowings	4,000	—	—
Proceeds from issuance of preferred stock	23,182	—	—
Proceeds from issuance of common stock	—	4,383	29,855
Proceeds from options exercise	116	102	1,237
Proceeds from dividend reinvestment	433	515	147
Common shares repurchased	(5,600)	—	—
Cash dividends paid	(3,539)	(1,674)	(631)
Tax benefit from exercise of stock options	43	293	—
Cash paid for fractional shares	—	—	(8)
	44,409	19,083	30,600
Net increase (decrease) in cash	2,678	(2,230)	(5,043)
Cash, beginning of year	1,679	3,909	8,952
Cash, end of year	$ 4,357	$ 1,679	$ 3,909

Table of Contents

NOTE Q — BUSINESS SEGMENT REPORTING

In addition to its banking operations, the Bank has three other reportable segments, Gateway Investment Services, Inc., whose principal activity is to engage in brokerage services as an agent for non-bank investment products and services, Gateway Bank Mortgage, a mortgage company which began operations during the second quarter of 2006 and Gateway Insurance Services, Inc., an independent insurance agency. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. Set forth below is certain financial information for each segment and in total (in thousands):

	At or for the Year Ended December 31, 2007					
	Consolidated	Adjustments	Banking	Brokerage	Insurance	Mortgage
Total interest income	$ 109,559	$ —	$ 109,041	$ —	$ 18	$ 500
Total interest expense	60,474	(447)	60,474	—	—	447
Net interest income	49,085	447	48,567	—	18	53
Provision for loan losses	4,900	—	4,900	—	—	—
Net interest income after provision for loan losses	44,185	447	43,667	—	18	53
Non-interest income	17,765	(1,780)	10,477	794	5,245	3,029
Non-interest expense	44,941	—	37,166	558	4,456	2,761
Income before income taxes	17,009	(1,333)	16,978	236	807	321
Provision for income taxes	5,990	—	5,990	—	—	—
Net income	$ 11,019	$ (1,333)	$ 10,988	$ 236	$ 807	$ 321
Period end total assets	$ 1,868,185	$ (15,665)	$1,868,185	$ 865	$ 9,022	$ 5,778

	At or for the Year Ended December 31, 2006					
	Consolidated	Adjustments	Banking	Brokerage	Insurance	Mortgage
Total interest income	$ 73,097	$ —	$ 72,940	$ —	$ 21	$ 136
Total interest expense	36,099	(149)	36,099	—	—	149
Net interest income	36,998	149	36,841	—	21	(13)
Provision for loan losses	3,400	—	3,400	—	—	—
Net interest income after provision for loan losses	33,598	149	33,441	—	21	(13)
Non-interest income	9,280	(676)	5,135	744	2,883	1,194
Non-interest expense	34,984	—	30,682	590	2,205	1,507
Income before income taxes	7,894	(527)	7,894	154	699	(326)
Provision for income taxes	2,625	—	2,625	—	—	—
Net income (loss)	$ 5,269	$ (527)	$ 5,269	$ 154	$ 699	$ (326)
Period end total assets	$ 1,207,477	$ (22,548)	$1,207,477	$ 645	$ 6,132	$ 15,771

	At or for the Year Ended December 31, 2005					
	Consolidated	Adjustments	Banking	Brokerage	Insurance	Mortgage
Total interest income	$ 39,679	$ —	$ 39,646	$ —	$ 33	$ —
Total interest expense	16,376	—	16,376	—	—	—
Net interest income		23,303	—	23,270	—	33
Provision for loan losses	2,200	—	2,200	—	—	—
Net interest income after provision for loan losses	21,103	—	21,070	—	33	—
Non-interest income	8,067	(713)	5,736	656	2,388	—
Non-interest expense	23,266	—	20,902	464	1,900	—
Income before income taxes	5,904	(713)	5,904	192	521	—
Provision for income taxes	1,965	—	1,965	—	—	—
Net income	$ 3,939	$ (713)	$ 3,939	$ 192	$ 521	$ —
Period end total assets	$ 883,373	$ (3,837)	$884,198	$ 488	$ 2,524	$

GATEWAY FINANCIAL HOLDINGS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007, 2006 and 2005

NOTE R — INTANGIBLE ASSETS AND GOODWILL

The following is a summary of intangible assets as of December 31, 2007, 2006 and 2005.

	2007	2006	2005
		(In thousands)	
Intangibles assets subject to future amortization:			
Core intangibles — gross	$ 4,961	$ 3,497	$ 3,497
Less accumulated amortization	(1,462)	(1,027)	(707)
Core intangible Net	3,499	2,470	2,790
Intangibles — book of business	1,821	1,821	188
Less accumulated amortization	(251)	(128)	(87)
	1,570	1,693	101
Intangibles — net	$ 5,069	$ 4,163	$ 2,891
Intangible assets not subject to future amortization:			
Goodwill — banking segment	$ 43,153	$ 6,454	$ 6,454
Goodwill — insurance segment	2,853	1,998	1,002
	$ 46,006	$ 8,452	$ 7,456

The following table presents the estimated amortization expense (in thousands) for intangible assets for each of the five years ending December 31, 2012 and the estimated amount amortizable thereafter. These estimates are subject to change in future periods to the extent management determines it is necessary to make adjustments to the carrying value or estimated useful life of amortizing intangible assets.

2008	$ 618
2009	618
2010	577
2011	560
2012	553
Thereafter	2,143
	$ 5,069

NOTE S — DERIVATIVES

On September 11, 2007 the Company sold the $150.0 million stand-alone derivative financial instrument which was entered into on December 30, 2005. The Company received an $115,000 termination fee from the counterparty for terminating its position in the financial instrument. The financial instrument was in the form of an interest rate swap agreement, which derived its value from underlying interest rates. These transactions involve both credit and market risk. The notional amount is the amount on which calculations, payments and the value of the derivative are based. Notional amounts do not represent direct credit exposures. Direct credit exposure is limited to the net difference between the calculated amounts to be received and paid. SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" requires that changes in the fair value of derivative financial instruments that do not qualify as hedging instruments be reported as an economic gain or loss in non-interest income. For the years ended December 31, 2007 and 2006 a gain of $1.2 million and a loss of $1.2 million, respectively, was included in non-interest income related to the change in the fair value of the interest rate swap agreement. Fair value changes in this derivative can be volatile from quarter to quarter, and are primarily driven by changes in interest rates. Net cash monthly settlements are recorded as non-interest income in the period to which they relate. For the years ended December 31, 2007 and 2006 the interest rate swap cash settlements decreased non-

NOTE S — DERIVATIVES (Continued)

interest income by $641,000 and $693,000, respectively. The 2007 cash settlements included the $115,000 termination fee described above.

The Company was exposed to credit related losses in the event of nonperformance by the counterparty to this agreement. The Company controls the credit risk of its financial contracts through credit approvals, limits and monitoring procedures, and does not expect the counterparty to fail their obligations.

This agreement required the Company to make monthly payments at a variable rate determined by a specified index (prime rate as stated in Publication H-15) in exchange for receiving payments at a fixed rate.

The Company had been required to provide collateral in the form of U.S. Treasury Securities of $2.0 million to the counterparty based on the evaluation of the market value of the agreement. The Company received back its collateral when the financial instrument was terminated.

ITEM 9 — CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A — CONTROLS AND PROCEDURES

The Company's management, with the participation of its Chief Executive Officer and the Chief Financial Officer has evaluated the effectiveness of the Company's disclosure controls and procedures as of December 31, 2007. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of December 31, 2007. There were no material changes in the Company's internal controls over financial reporting during the fourth quarter of 2007.

Management's Report On Internal Control Over Financial Reporting

The management of Gateway Financial Holdings, Inc. and Subsidiary (the "Company") is responsible for preparing the Company's annual consolidated financial statements and for establishing and maintaining adequate internal control over financial reporting. The Company's internal control system was designed to provide reasonable assurance to management and board of directors regarding the preparation and fair presentation of published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2007. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in *Internal Control — Integrated Framework*. Based on that assessment, we believe that, as of December 31, 2007, the Company's internal control over financial reporting is effective based on those criteria.

The Company's registered public accounting firm that audited the Company's consolidated financial statements included in this annual report has issued an attestation report on the effectiveness of the Company's internal control over financial reporting.

March 14, 2008

/s/ D. Ben Berry	*/s/ Theodore L. Salter*
D. Ben Berry	Theodore L. Salter
Chairman, President and Chief Executive Officer	Senior Executive Vice President and Chief Financial Officer

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Gateway Financial Holdings, Inc.

We have audited Gateway Financial Holdings, Inc. and Subsidiary's (the "Company") internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control, based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Gateway Financial Holdings, Inc. and Subsidiary maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of Gateway Financial Holdings, Inc. and Subsidiary as of and for the year ended December 31, 2007, and our report dated March 10, 2008, expressed an unqualified opinion on those consolidated financial statements.

Greenville, North Carolina
March 10, 2008

ITEM 9B — OTHER INFORMATION

None.

PART III

ITEM 10 — DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Incorporated by reference from the Company's definitive proxy statement, to be mailed to stockholders and filed with the Securities and Exchange Commission within 120 days of December 31, 2007.

ITEM 11 — EXECUTIVE COMPENSATION

Incorporated by reference from the Company's definitive proxy statement, to be mailed to stockholders and filed with the Securities and Exchange Commission within 120 days of December 31, 2007.

ITEM 12 — SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Incorporated by reference from the company's definitive proxy statement, to be mailed to shareholders and filed with the Securities and Exchange Commission within 120 days of December 31, 2007.

The following table sets forth equity compensation plan information at December 31, 2007.

Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options	Weighted-average exercise price of outstanding options	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column(a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	1,721,954	$9.89	644,678
Equity compensation plans not approved by security holders	150,032	$6.14	—
Total	1,871,986	$9.59	644,678

A description of the Company's equity compensation plans is presented in Note N to the accompanying consolidated financial statements.

The 2001 Nonstatutory Stock Option Plan ("NSSO Plan") was not approved by security holders. Options granted under the NSSO Plan do not qualify as "incentive stock options" within the meaning of Section 422A of the Internal Revenue Code and do not afford favorable tax treatment to recipients. Options granted under the NSSO Plan do result in tax deductions to the Company. The NSSO Plan is administered by the Executive Committee. Directors and employees of the Company are eligible to receive options under the NSSO Plan at no cost to them other than the option exercise price. The options must be exercised within ten years from the date of grant. In the event that a participant ceases to serve as a director or employee of the Company due to disability or retirement, as defined in the NSSO Plan, an exercisable stock option will continue to be exercisable upon the terms and conditions contained in the grant. In the event of the death of a participant during service, an exercisable stock option will continue to be exercisable for 12 months from the date of death to the extent it was exercisable by the participant immediately prior to death. In the event that a participant ceases to serve as a director or employee of the Company for any other reason, the options will terminate.

ITEM 13 — CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Incorporated by reference from the Company's definitive proxy statement, to be mailed to stockholders and filed with the Securities and Exchange Commission within 120 days of December 31, 2007.

ITEM 14 — PRINCIPAL ACCOUNTANT FEES AND SERVICES

Incorporated by reference from the Company's definitive proxy statement, to be mailed to stockholders and filed with the Securities and Exchange Commission within 120 days of December 31, 2007.

PART IV

ITEM 15 — EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a)(3) Exhibits. The exhibits required by Item 601 of Regulation S-K are listed below.

Exhibit No.	Description
Exhibit 3.1:	Amended and Restated Articles of Incorporation
Exhibit 3.2:	Articles of Amendment to the Articles of Incorporation
Exhibit 3.3:	Amended Bylaws
Exhibit 4.1:	Specimen Certificate for Common Stock of Gateway Financial Holdings, Inc. (incorporated by reference to Exhibit 4.1 of Amendment No. 1 to the Registration Statement on Form S-3 filed September 20, 2001)
Exhibit 10.1:	1999 Incentive Stock Option Plan of Gateway Financial Holdings, Inc. (incorporated by reference to Exhibit 10.1 to the Annual Report on Form 10K for the year ended December 31, 2001 ("2001 Annual Report"))
Exhibit 10.2:	1999 Non-Statutory Stock Option Plan of Gateway Financial Holdings, Inc. (incorporated by reference to Exhibit 10.2 to the 2001 Annual Report)
Exhibit 10.3:	2001 Non-Statutory Stock Option Plan of Gateway Financial Holdings, Inc. (incorporated by reference to Exhibit 10.3 to the 2001 Annual Report)
Exhibit 10.4	Amended Employment Agreement with D. Ben Berry
Exhibit 10.5	Amended Employment Agreement with David R. Twiddy
Exhibit 10.6	2005 Omnibus Stock Ownership And Long Term Incentive Plan (incorporated by reference to Exhibit 10.6 to the Annual Report on Form 10K for the year ended December 31, 2005)
Exhibit 10.7	Amended Employment Agreement with Theodore L. Salter
Exhibit 10.8	Salary Continuation Agreement with D. Ben Berry
Exhibit 10.9	Salary Continuation Agreement with David R. Twiddy
Exhibit 10.10	Amended Change in Control Agreement with Matthew D. White
Exhibit 21:	Subsidiaries of the Registrant
Exhibit 23:	Consent of Dixon Hughes PLLC
Exhibit 31.1:	Rule 13a-14(a)/15d-14(a) Certification by Chief Executive Officer
Exhibit 31.2:	Rule 13a-14(a)/15d-14(a) Certification by Chief Financial Officer
Exhibit 32:	Section 1350 Certifications

Table of Contents

SIGNATURES

Pursuant to the requirements of the Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on behalf of the undersigned, thereunto duly authorized.

GATEWAY FINANCIAL HOLDINGS, INC.

Date: March 14, 2008

By: */s/ D. Ben Berry*
D. Ben Berry
Chairman, President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

NAME	TITLE	DATE
/s/ D. Ben Berry D. Ben Berry	Chairman, President and CEO	March 14, 2008
/s/ Theodore L. Salter Theodore L. Salter	Chief Financial Officer	March 14, 2008
/s/ H. Spencer Barrow H. Spencer Barrow	Director	March 14, 2008
/s/ William Brumsey III William Brumsey III	Director	March 14, 2008
/s/ Jimmie Dixon, Jr. Jimmie Dixon, Jr.	Director	March 14, 2008
/s/ James H. Ferebee, Jr. James H. Ferebee, Jr.	Director	March 14, 2008
/s/ Charles R. Franklin, Jr. Charles R. Franklin, Jr.	Director	March 14, 2008
/s/ Robert Y. Green, Jr. Robert Y. Green, Jr.	Director	March 14, 2008
/s/ W. Taylor Johnson, Jr. W. Taylor Johnson, Jr.	Director	March 14, 2008
/s/ Robert Willard Luther, III Robert Willard Luther, III	Director	March 14, 2008
/s/ Frances Morrisette Norrell Frances Morrisette Norrell	Director	March 14, 2008
/s/ W. C. Owens, Jr. W. C. Owens, Jr.	Director	March 14, 2008
William A. Paulette William A. Paulette	Director	March 14, 2008
/s/ Billy G. Roughton Billy G. Roughton	Director	March 14, 2008
/s/ Ollin B. Sykes Ollin B. Sykes	Director	March 14, 2008
/s/ Frank T. Williams Frank T. Williams	Director	March 14, 2008

Jerry T. Womack	Director	March 14, 2008
Jerry T. Womack		

Section 2: EX-3.1 (EXHIBIT 3.1)

Exhibit 3.1

AMENDED AND RESTATED
ARTICLES OF INCORPORATION
OF
GATEWAY FINANCIAL HOLDINGS, INC.

Pursuant to Section 55-10-07 of the General Statutes of North Carolina, the undersigned corporation hereby submits these Amended and Restated Articles of Incorporation for the purpose of integrating into one document its original articles of incorporation and all amendments thereto and also for the purpose of amending its articles of incorporation:

1. The name of the corporation is Gateway Financial Holdings, Inc.

2. Attached hereto as an exhibit are the Amended and Restated Articles of Incorporation, which contain an amendment to the articles of incorporation requiring shareholder approval.

3. The Amended and Restated Articles of Incorporation of the corporation were adopted by its shareholders on May 30, 2007, in the manner prescribed by Chapter 55 of the North Carolina General Statutes.

4. The Amended and Restated Articles of Incorporation do not contain an amendment providing for an exchange, reclassification, or cancellation of issued shares.

5. These articles will be effective upon filing.

This the 8th day of June, 2007.

Gateway Financial Holdings, Inc.

By: /s/ D. Ben Berry
D. Ben Berry
Chairman, President and Chief Executive Officer

AMENDED AND RESTATED
ARTICLES OF INCORPORATION
OF
GATEWAY FINANCIAL HOLDINGS, INC.

The undersigned hereby submits these Articles of Incorporation for the purpose of forming a business corporation under the laws of the State of North Carolina:

I.

The name of the corporation is "Gateway Financial Holdings, Inc."

II.

The amount of authorized Capital Stock of the Corporation shall be 31,000,000 shares, to be divided into 30,000,000 shares of common stock, no Par Value, and 1,000,000 shares of Preferred Stock, no Par Value. The common stock shall be of one class. Subject to the rights of the preferred stock as determined by the Board of Directors, the holders of the common stock shall have one vote per share on all matters on which holders of the common stock are entitled to vote. The shares of preferred stock may be issued from time to time by the Corporation in such series as the Board of Directors may determine and shall have such voting powers, designations, preferences, limitations, and relative rights as the Board of Directors may and hereby is authorized to determine.

III.

The address of the registered office of the corporation is 1145 North Road Street, Elizabeth City (Pasquotank County), North Carolina 27909, and the name of the registered agent at such address is David R. Twiddy.

IV.

The number of directors constituting the board of directors shall be as established in the bylaws.

V.

The Corporation shall indemnify and hold harmless to the fullest extent from time to time permitted by law any person who was or is a party or is threatened to be made a party to any threatened, pending, or completed civil, criminal, administrative, investigative, or arbitrative action, suit or proceeding and any appeal therein (and any inquiry or investigation that could lead to such action, suit, or proceeding) by reason of the fact that such person is or was a director, officer, employee, or agent of the Corporation or its predecessor unincorporated association, or is or was serving at the request of the Corporation as a director, officer, employee, or agent of another corporation, partnership, joint venture, trust, or other enterprise, or as trustee or administrator under an employee benefit plan. The indemnification provided for herein shall, to the fullest extent from time to time permitted by law, apply against all liability and expense incurred by any such person in connection with such action, suit, or proceeding, including, without limitation, all reasonable attorneys' fees and expenses, judgments, fines, excise taxes, and amounts paid in settlement, and all reasonable costs, expenses, and attorneys' fees incurred in connection with the enforcement of such rights to indemnification. The termination of any

action, suit, or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that any such person did not meet any requisite standard of conduct imposed by law in order to be entitled to such indemnification. To the fullest extent from time to time permitted by law, expenses of any such person incurred in defending any civil or criminal action, suit, or proceeding shall be paid by the Corporation in advance of the final disposition of such action, suit, or proceeding. The rights of indemnification set forth herein shall inure to the benefit of any such person, whether or not such person is an officer, director, employee, or agent at the time such liabilities or expenses are imposed or incurred, and, in the event of such person's death, shall extend to his or her legal representative. The rights to indemnification hereunder shall be in addition to and not exclusive of any other rights to which any such person may be entitled under any statute, agreement, insurance policy, or otherwise.

VI.

No individual serving as a director of the Corporation shall be personally liable in an action whether by or in the right of the Corporation or otherwise for monetary damages for breach of such person's duty as a director of the Corporation; provided, however, that the foregoing clause shall not apply to any liability of a director with respect to (i) acts or omissions not made in good faith that the director at the time of breach knew or believed were in conflict with the best interests of the Corporation; (ii) any liability under Section 55-8-33 of the North Carolina General Statutes; or (iii) any transaction from which the director derived an improper personal benefit (which does not include a director's compensation or other incidental benefit for or on account of his service as a director, officer, employee, independent contractor, attorney, or consultant of the Corporation). If the North Carolina General Statutes are amended after the filing of these Articles to authorize corporate action further eliminating or limiting the personal liability of directors, then the liability of a director of the Corporation shall be eliminated or limited to the fullest extent permitted by the North Carolina General Statutes, as so amended. No amendment or repeal of the provisions of this Article VI shall apply to or have any affect on the liability or alleged liability of any director of the Corporation for or with respect to any act or failure to act on the part of such director occurring prior to such amendment or repeal. This provision shall not affect any charter or by-law provision or contract or resolution of the Corporation indemnifying or agreeing to indemnify a director against personal liability pursuant to and in accordance with the North Carolina General Statutes.

VII.

In connection with the exercise of its or their judgment in determining what is in the best interests of the corporation and its shareholders, the Board of Directors of the corporation, any committee of the Board of Directors, or any individual director may, but shall not be required to, in addition to considering the long-term and short-term interests of the shareholders, consider any of the following factors and any other factors which it or they deem relevant: (i) the social and economic effects of the matter to be considered on the corporation and its subsidiaries, its and their employees, depositors, customers, and creditors, and the communities in which the corporation and its subsidiaries operate or are located; and (ii) when evaluating a business combination or a proposal by another person or persons to make a business combination or a tender or exchange offer or any other proposal relating to a potential change of control of the corporation (x) the business and financial condition and earnings prospects of the acquiring person or persons, including, but not limited to, debt service and other existing financial

obligations of the acquiring person or persons, and the possible effect of such conditions upon the corporation and its subsidiaries and the communities in which the corporation and its subsidiaries operate or are located, (y) the competence, experience, and integrity of the acquiring person or persons and its or their management, and (z) the prospects for successful conclusion of the business combination, offer or proposal. The provisions of this Article VII shall be deemed solely to grant discretionary authority to the directors and shall not be deemed to provide to any constituency the right to be considered. As used in this Article VII, the term "person" means any individual, partnership, firm, corporation, association, trust, unincorporated organization or other entity; and, when two or more persons act as a partnership, limited partnership, syndicate, or other group acting in concert for the purpose of acquiring, holding, voting or disposing of securities of the corporation, such partnership, limited partnership, syndicate or group shall also be deemed a "person" for purposes of this Article VII.

Section 3: EX-3.2 (EXHIBIT 3.2)

Exhibit 3.2

ARTICLES OF AMENDMENT TO THE ARTICLES OF INCORPORATION OF GATEWAY FINANCIAL HOLDINGS, INC.

Pursuant to Section 55-10-06 of the General Statutes of North Carolina, the undersigned corporation hereby submits these Articles of Amendment for the purpose of amending its Articles of Incorporation to create a series of Preferred Stock and to fix the preferences, limitations and relative rights of shares of Preferred Stock within that series.

1. The name of the corporation is Gateway Financial Holdings, Inc. (the "corporation").

2. The corporation's Articles of Incorporation hereby are amended by adding a new subsection A to Article II thereof as follows:

"A. Of the 1,000,000 authorized shares of Preferred Stock, a series of Preferred Stock shall be as follows:

Designation of Series	Number of Shares	Par Value per Share
Series A Preferred Stock	25,000	No Par Value

The terms, relative rights, preferences and limitations of the Series A Preferred Stock shall be as follows:

Dividends: The holders of shares of Series A Preferred Stock are entitled to receive stated cash dividends from the corporation at an annual rate of 8.75%, and no more, subject to declaration by the Board of Directors, at its sole discretion, from funds legally available for the payment of dividends. Dividends will be computed on the basis of a 360-day year of twelve 30-day months. Dividends on the Series A Preferred Stock will not be cumulative on a year-to-year basis. Dividends will be payable as they are declared by the Board of Directors at such time or times as it elects, and no holder of Series A Preferred Stock will have any right to receive any dividend unless and until that dividend has been declared by the Board of Directors. The stated annual dividend may be declared and paid in increments during each calendar year. In connection with each dividend payment, the Board of Directors may set a record date in advance of the payment date for the purpose of determining the holders of shares of Series A Preferred Stock who are entitled to receive that dividend.

No dividend shall be declared or paid during any calendar year on the corporation's common stock unless and until there shall have been paid in full to the holders of Series A Preferred Stock (or set apart for purposes of such

payment), without preference or priority as between such shares or other series of Preferred Stock, not less than a pro rata portion of the stated annual dividend thereon for that calendar year, at the rate provided therefor, through the date on which the corporation proposes to pay the cash dividend on the common stock. Shares of Series A Preferred Stock shall not participate in dividends paid with respect to any other class or series of the corporation's capital stock.

Liquidation: In the event of liquidation, dissolution or winding up of the corporation, whether voluntarily or involuntarily (a "Corporate Event"), the holders of the corporation's Series A Preferred Stock, without preference or priority as between such shares or other series of Preferred Stock, but prior to any distribution of assets to holders of the corporation's common stock, shall be entitled to receive from assets available for distribution to shareholders, for each such share held, a sum equal to $1,000.00 plus the amount of any dividend on such share which has been declared by the Board of Directors but has not yet been paid. Such distribution shall be considered full payment to the holders of Series A Preferred Stock, and such holders shall not participate with the holders of any other class or series of the corporation's capital stock in the distribution of any additional assets of the corporation.

Voting: Shares of Series A Preferred Stock shall be non-voting shares, and holders of Series A Preferred Stock shall have no right to vote on matters submitted to a vote of the corporation's shareholders except to the extent such voting rights are required by applicable law.

Redemption: After January 1, 2009, the corporation shall have the right and option to redeem all or a portion of the outstanding shares of Series A Preferred Stock at the rate of $1,000.00 for each one whole share of Series A Preferred Stock. In the case of a redemption of less than all of the then outstanding shares of Series A Preferred Stock, the shares will be redeemed proportionately in such manner as its Board of Directors, at its sole discretion, considers reasonable and appropriate and, when made, the Board of Director's determination shall be final, conclusive and binding on all persons, including, without limitation, the corporation and the holders of Series A Preferred Stock."

3. The foregoing amendment was duly adopted by the corporation's Board of Directors without shareholder action, which was not required because the Articles of Incorporation provide that the Board of Directors may establish series of the corporation's preferred stock and determine the preferences, limitations and relative rights of each series of shares before the issuance of any shares of such series in accordance with Section 55-6-02 of the General Statutes of North Carolina.

4. These Articles of Amendment will become effective upon filing.

This the 26th day of December, 2007.

Gateway Financial Holdings, Inc.

By: /s/ D. Ben Berry
D. Ben Berry, President and
Chief Executive Officer

Section 4: EX-3.3 (EXHIBIT 3.3)

Exhibit 3.3

AMENDED AND RESTATED
BYLAWS
GATEWAY FINANCIAL HOLDINGS, INC.

BYLAWS
OF
GATEWAY FINANCIAL HOLDINGS, INC.

Index

ARTICLE I

Offices

Section 1. Principal Offices
Section 2. Registered Office
Section 3. Other Offices

ARTICLE II

Meetings of Shareholders

Section 1. Annual Meeting
Section 2. Substitute Annual Meeting
Section 3. Special Meetings
Section 4. Place of Meetings
Section 5. Notice of Meetings
Section 6. Waiver of Notice
Section 7. Voting Lists
Section 8. Quorum
Section 9. Voting
Section 10. Proxies

ARTICLE III

Board of Directors

Section 1. General Powers
Section 2. Number, Term of Office and Qualifications
Section 3. Election of Directors
Section 4. Directors' Immunity
Section 5. Removal of Directors
Section 6. Vacancies
Section 7. Compensation of Directors
Section 8. Committees
Section 9. Chairman and Vice Chairman of Board
Section 10. Nominations

ARTICLE IV

Meetings of Directors

Section 1. Regular Meetings
Section 2. Special Meetings
Section 3. Place of Meetings
Section 4. Notice of Meetings
Section 5. Quorum; Manner of Acting
Section 6. Presumption of Assent
Section 7. Informal Action of Directors
Section 8. Resignations
Section 9. Minutes

ARTICLE V

Officers

Section 1. Number of Officers
Section 2. Election, Term of Office and Qualifications
Section 3. Subordinate Officers and Agents
Section 4. Removal
Section 5. Resignations
Section 6. Vacancies
Section 7. President
Section 8. Vice President
Section 9. Secretary
Section 10. Assistant Secretary
Section 11. Treasurer
Section 12. Duties of Officers May Be Delegated
Section 13. Salaries of Officers
Section 14. Bonds

ARTICLE VI

Contracts, Loans, Deposits, Checks, Drafts, Etc.

Section 1. Contracts
Section 2. Loans
Section 3. Deposits
Section 4. Checks, Drafts, Etc.

ARTICLE VII

Share Certificates and Their Transfer

Section 1. Share Certificates
Section 2. Transfers of Shares
Section 3. Lost or Destroyed Certificates
Section 4. Regulations
Section 5. Fixing Record Date

Section 6. Holder of Record
Section 7. Reacquired Shares

ARTICLE VIII

General Provisions

Section 1. Corporate Seal
Section 2. Distributions
Section 3. Fiscal Year
Section 4. Waiver of Notice
Section 5. Amendments
Section 6. Indemnification
Section 7. Interpretation of Bylaws

CODE OF BYLAWS

GATEWAY FINANCIAL HOLDINGS, INC.

ARTICLE I

Offices

Section 1. Principal Office. The Corporation's principal office shall be located in Elizabeth City, North Carolina, or at such other place(s) as the Board may designate from time to time.

Section 2. Registered Office. The Corporation's registered office, which by law is required to be maintained within the State, shall be located at such place or places within the State of North Carolina as the Board may designate from time to time.

Section 3. Other Offices. The Corporation may have offices at such places, either within or outside the State, as the Board may determine from time to time.

ARTICLE II

Meeting of Shareholders

Section 1. Annual Meeting. The annual meeting of shareholders shall be held within 150 days of the close of the fiscal year, as set by the Board, for the purpose of electing directors of the Corporation and for the transaction of such other business as properly may be brought before the meeting.

Section 2. Substitute Annual Meeting. If the annual meeting shall not be held on the day designated by these Bylaws, a substitute annual meeting may be called in the manner provided for the call of a special meeting in accordance with the provisions of Section 3 of this Article and a substitute annual meeting so called shall be designated as and shall be treated, for all purposes, as the annual meeting.

Section 3. Special Meetings. Special meetings of the shareholders may be called at any time by (a) the President of the Corporation, (b) the Chairman of the Corporation, (c) the Secretary of the Corporation or (d) the Board.

Section 4. Place of Meetings. All meetings of shareholders shall be held at the principal office of the Corporation or at such other place, either within or without the State of North Carolina, as shall be designated in the notice of the meeting or agreed upon by a majority of the shareholders entitled to vote thereat.

Section 5. Notice of Meetings. Written or printed notice stating the time and place of a shareholders' meeting shall be delivered, personally or by mail, by or at the direction of the President, the Board or by such other person or persons calling such meeting, to each shareholder of record entitled to vote at such meeting, not less than ten or more than sixty days prior to the date of such meeting. If mailed, such notice shall be deemed to be delivered when deposited in the United States mail addressed to the shareholder to the address determined in the manner indicated below, with postage thereon prepaid. A statement of the business to be transacted at an annual or substitute annual meeting of shareholders need

not be set forth in the notice of such meeting except that if any matter is to be considered or acted upon, other than the election of directors, on which the vote of shareholders is required under the provisions of the Act then a specific statement thereof shall be set forth in such notice. In the case of a special meeting, the notice shall set forth the nature of the business to be transacted. If any meeting of shareholders is adjourned to a different date, time, or place, notice need not be given of the new date, time, or place if the new date, time, or place is announced at the meeting before adjournment and if a new record date is not fixed for the adjourned meeting. If a new record date for the adjourned meeting is or must be fixed pursuant to the Act, notice of the adjourned meeting must be given as provided in this Section to persons who are shareholders as of the new record date. Any notice which shall be mailed shall be directed to each shareholder at its address as set forth on the Corporation's share books, except that if any shareholder shall have filed with the Secretary a written request that notices intended for such shareholder be mailed to some other address, then notice to such shareholder shall be mailed to the address set forth in such written request.

Section 6. Waiver of Notice. Any shareholder may waive notice of any meeting before or after the meeting. The waiver must be in writing, signed by the shareholder, and delivered to the Corporation for inclusion in the minutes or filing with the corporate records. A shareholder's attendance, in person or by proxy, at a meeting (a) waives objection to lack of notice or defective notice of the meeting, unless the shareholder or the shareholder's proxy at the beginning of the meeting objects to holding the meeting or transacting business thereat, and (b) waives objection to consideration of a particular matter at the meeting that is not within the purpose or purposes described in the meeting notice, unless the shareholder or the shareholder's proxy objects to considering the matter before it is voted upon.

Section 7. Voting Lists. No later than two days after notice of a shareholder is given, the Secretary shall prepare an alphabetical list of the shareholders entitled to notice of such meeting. The Secretary shall maintain such list and make it available as provided by the Act.

Section 8. Quorum. Except as otherwise provided by the Act, the Articles or these Bylaws, the presence in person or by proxy of holders of record of a majority of the shares entitled to vote shall be necessary to constitute a quorum for action on such matters; provided, however, that at any substitute annual shareholders' meeting called in accordance with Section 2 of this Article, the shares entitled to vote there represented, in person or by proxy, shall constitute a quorum. In the absence of a quorum, a majority of the shares entitled to vote there represented, in person or by proxy, may adjourn the meeting from time to time. At any such adjourned meeting, at which a quorum shall be present, any business may be transacted which might have been transacted at the meeting as originally called if a quorum had been there present. Once a share is represented for any purpose at a meeting, it is deemed present for quorum purposes for the remainder of the meeting and for any adjournment of that meeting unless a new record date is or must be set for that adjourned meeting.

Section 9. Voting. At each shareholders' meeting, every holder of record of shares entitled to vote shall be entitled to one vote for every share standing in his name on the Corporation's books, unless otherwise provided by the terms of such shares, and all questions, except as otherwise provided by the Act, the Articles, or these Bylaws, shall be determined by a majority of the votes so cast. Any provision in these Bylaws prescribing the vote required for any purpose as permitted by law may not itself be amended by a vote less than the vote prescribed therein. Persons holding shares in a fiduciary capacity shall be entitled to vote the shares so held. Shares owned by the Corporation, directly or indirectly, through a subsidiary corporation or otherwise, or held directly or indirectly in a fiduciary capacity by it or by a subsidiary corporation, shall not be voted at any shareholders' meeting and shall not be counted in

determining the total number of outstanding shares at a given time entitled to vote, except to the extent permitted by the Act. Voting on all matters, except the election of Directors, shall be by voice vote or by show of hands except that if prior to voting on any particular matter demand shall be made by or on behalf of the holders of not less than one-tenth (1/10th) of the shares represented, in person or by proxy, at such meeting and entitled to vote on such matter that the vote thereon be taken by ballot, then the vote on such matter shall be taken by ballot.

Section 10. Proxies. Any shareholder entitled to vote may vote by proxy, provided that the instrument authorizing such proxy to act shall have been executed in writing by the shareholder or his duly authorized attorney. No proxy shall be valid after the expiration of eleven months from the date of its execution, unless the person executing it shall have specified therein the length of time it is to continue in force or limits its use to a particular meeting. Each instrument designating a proxy shall be exhibited to the Secretary and shall be filed with the Corporation's records.

ARTICLE III

Board of Directors

Section 1. General Powers. All corporate powers shall be exercised by or under the authority of and the business and affairs of the Corporation manage under the direction of, the Board, except as otherwise provided in the Articles.

Section 2. Number, Term of Office and Qualifications.(a) The number of directors shall be not less than seven (7) nor more than seventeen (17) shareholders. The exact number of directors, within the minimum and maximum limitations of the preceding sentence, shall be fixed from time to time by the Board pursuant to a resolution adopted by a majority of the entire Board prior to the annual meeting of shareholders at which such directors are to be elected. In addition to the foregoing relating to the determination of the number and election of directors, the shareholders, at any meeting thereof, may authorize not more than two (2) additional directorships, which may be left unfilled by the shareholders at such meeting, to be filled in the discretion of the directors during the interval between meetings of the shareholders.

(b) At the first annual meeting of shareholders, the Board shall be divided into three classes, containing as nearly equal a number of directors as possible, with the term of office for the first class to expire at the first annual meeting of shareholders after their election, the term of office for the second class to expire at the second annual meeting of shareholders after their election, and the term of office for the third class to expire at the third annual meeting of the shareholders after their election. At each annual meeting of shareholders following such initial classification and election, directors elected to succeed those directors whose terms expire shall be selected for a term of office to expire the third succeeding annual meeting of shareholders after their election. In the event of any increase or decrease in the number of directors, the additional or eliminated directorships shall be so classified or chosen so that all classes of directors shall remain and become as nearly equal in number as possible. Each director shall continue in office until the expiration of his term as specified above and until his successor shall have been elected and qualified, or until his death or until the director shall resign or shall have become disqualified or shall have been removed in the manner hereinafter provided. No director shall serve past the annual meeting after reaching the age of seventy five (75) regardless of the number of years remaining in his or her term; provided that any such director may continue to serve as an honorary director; further provided that any director serving at the date of adoption of these bylaws who had attained the age of seventy (70) may

serve until the completion of the term during which the director reaches the age of seventy seven (77). An honorary director may attend meetings of the Board, but may not vote, serve as an officer of the Board, or receive any fee or other benefit of Board membership.

Section 3. Election of Directors. Except as provided in Section 6 of this Article, the Directors shall be elected at the shareholders' annual meeting of shareholders and the persons who shall receive the highest number of votes shall be the elected directors. If prior to voting for the election of Directors demand therefor shall be made by or on behalf of any share entitled to vote at such meeting, the election of directors shall be by ballot.

Section 4. Directors' Immunity. To the fullest extent permitted by law, each Director shall be immune from personal liability of each Director arising out of an action whether by or in the right of the Corporation or otherwise for monetary damages for breach of any duty as a Director.

Section 5. Removal of Directors. Any director may be removed from office at any time with or without cause by either (i) a two-thirds (2/3) vote of all the directors or (ii) a vote of shareholders whenever the number of votes cast in favor of removal of the director exceeds the number of votes cast against such removal. A director may not be removed by the shareholders at a meeting unless the notice of the meeting states that the purpose, or one of the purposes, of the meeting is removal of the director. If any directors are so removed, new directors may be elected at the same meeting to fill the unexpired term of the removed director.

Section 6. Vacancies. Except as provided in Section 2 of this Article, a vacancy in the Board created by an increase in the authorized number of Directors shall be filled only by election at an annual meeting of shareholders or at a special meeting of shareholders called for that purpose; provided, however, that prior to the issuance of the Corporation's shares any such vacancy may be filled by the then existing Board. Any vacancy in the Board created other than by an increase in the authorized number of Directors may be filled by a majority of the remaining Directors, even though less than a quorum, or by the sole remaining Director. The shareholders may elect a Director at any time to fill any vacancy not filled by the Directors. In the event of the resignation of a Director to take effect at a future date either the Board or the shareholders, at any time after tender of such resignation, may elect a successor to such Director to take office as of the effective date of such resignation. Any Director elected to fill a vacancy shall be elected for the unexpired term of his predecessor.

Section 7. Compensation of Directors. The Board may cause the Corporation to compensate Directors for their services as Directors and may provide for the payment by the Corporation of all expenses incurred by directors in attending regular and special meetings of the Board.

Section 8. Committees. The Board, by resolution of a majority of the number of directors in office, may designate three or more directors to constitute an Executive Committee and such other committees as the Board shall deem advisable, each of which, to the extent authorized by law and provided in such resolution, shall have and may exercise all of the authority of the Board in the management of the Corporation. The designation of any committee and the delegation thereto of authority shall not operate to relieve the Board, or any member thereof, of any responsibility or liability imposed upon the Board, or any member thereof, by law.

Section 9. Chairman and Vice Chairman of Board. The Directors shall elect a Chairman and may elect a Vice Chairman from their number at any meeting of the Board. The Chairman shall preside at all meetings of the Board and perform such other duties as the Board may direct.

Section 10. Nominations. Only persons who are nominated in accordance with the provisions set forth in these bylaws shall be eligible to be elected as directors at an annual or special meeting of shareholders. Nomination for election to the Board shall be made by or at the direction of the Nominating Committee appointed by the Board. Nomination for election of any person to the Board may also be made by a shareholder entitled to vote on such election if written notice of the nomination of such person shall have been received by the Secretary of the Corporation at the principal office of the Corporation on a day which is at least seven business days and not more than 60 days prior to the date of the meeting. Each such notice shall set forth: (a) the name and address of the shareholder who intends to make the nomination; (b) a representation that such shareholder is a holder of the record of shares of the Corporation entitled to vote at such meeting and intends to appear in person or by proxy at the meeting to nominate the person or persons specified in the notice; (c) as to each person to be nominated (i) such person's name and address, employment history for the past five years, affiliations, if any, with the Corporation and other corporations, the number of shares of the Corporation that are owned of record or beneficially by such person and information concerning any transactions in such shares within the prior 60 days, whether such person has been convicted in a criminal preceding (excluding traffic violations or similar misdemeanors) within the past five years and the details thereof, whether such person has been a party to any proceeding or subject to any judgment, decree or final order with respect to violations of federal or state securities laws within the past five years and the details thereof, and the details of any contract, arrangement, understanding or relationships with any person with respect to any securities of the Corporation; (ii) such person's written consent to being named as a nominee and to serving as a director if elected; and (iii) a description of all arrangements or understanding between the shareholder and each nominee and any other person or persons (naming such person or persons) pursuant to which the nomination or nominations are to be made by the shareholder. The person or persons, as the case may be, presiding over the meeting may refuse to acknowledge the nomination of any person not made in compliance with the foregoing procedure, and upon the presiding person's instruction, the voting inspectors may disregard all votes cast for each such nominee.

ARTICLE IV

Meetings of Directors

Section 1. Regular Meetings. A regular annual meeting of the Board may be held immediately after the shareholders' annual meeting and if not then held shall be held within a reasonable time thereafter. In addition, the Board may provide, by resolution, the time and place, within or without the State, for the holding of additional regular meetings. The Board shall meet at least quarterly, including the regular meeting to be held immediately or shortly after the annual meeting of shareholders.

Section 2. Special Meetings. Special Board meetings may be called by or at the request of the President or any two Directors.

Section 3. Place of Meetings. All Board meetings shall be held at the Corporation's principal office except that such meetings may be held at such other place, within or without the State, as may be

designated by the President or in a duly executed waiver of notice of such meeting or as may be otherwise agreed upon in advance of the meeting by a majority of Directors.

Section 4. Notice of Meetings. Regular meetings of the Board may be held without notice. Special meetings shall be called on not less than three (3) days' prior notice. Notice of a special meeting need not state the purpose thereof, unless otherwise required by the Act or these Bylaws, and such notice shall be directed to each Director at his residence or usual place of business by mail, cable or telegram, or may be delivered personally. A Director's presence at a meeting shall constitute a waiver of notice of that meeting except when such Director attends the meeting solely for the purpose of objecting to the transaction of any business thereat, on the grounds that the meeting has not been lawfully called, and does not otherwise participate in such meeting.

Section 5. Quorum; Manner of Acting. A majority of the number of Directors then authorized as the number of Directors of the Corporation shall constitute a quorum for the transaction of any business at any meeting. Except as otherwise expressly provided in the Articles or these Bylaws, the act of a majority of the Directors present at a meeting at which a quorum is present shall be the act of the Board. The vote of a majority of the Directors then holding office shall be required to adopt, amend or repeal a Bylaw or to dissolve the Corporation pursuant to the Act without shareholder consent.

Section 6. Presumption of Assent. A Director who is present at a Board meeting at which action on any matter is taken shall be presumed to have assented to the action taken on any such matter unless (a) his contrary vote is recorded or his dissent or abstention is otherwise entered in the minutes of the meeting, (b) the Director files his written dissent or abstention to such action with a person acting as the secretary of the meeting before the adjournment thereof or (c) the Director forwards such dissent or abstention by registered mail to such secretary immediately after the adjournment of the meeting. Such right to dissent or abstention shall not apply to a Director who voted in favor of such action.

Section 7. Informal Action of Directors. Action taken without a meeting shall constitute action of the Board if written consent to the action in question is signed by a majority of (or of a committee appointed by the Board in accordance with these Bylaws) the Directors then holding office or members of the committee, as the case may be, and filed with the minutes of the proceedings of the Board or such committee, whether done before or after the action so taken. Any one or more Directors may participate in any Board or committee meeting by means of a conference telephone or similar communications device which allows all persons participating in the meeting simultaneously to hear each other, and such participation in a meeting shall be deemed presence in person at such meeting.

Section 8. Resignations. A Director may resign at any time by communicating his resignation to the Board, its chairman, or the Corporation. A resignation is effective when it its communicated unless it specifies in writing a later effective date or subsequent event upon which it will become effective. Unless otherwise specified therein, the acceptance of any such resignation shall not be necessary to make it effective.

Section 9. Minutes. The Secretary or an Assistant Secretary shall keep minutes of all Board meetings, and the same shall be recorded in a book or books which shall be kept for that purpose, which book of books shall be kept on file in the Corporation. The minutes shall show a record of all action taken by the Board concerning the Corporation's conduct, management, and welfare. The minutes of any meeting of a Board committee, showing the actions taken by such committee since the last meeting, shall

be submitted to the Board at each Board meeting. All minutes must be signed by either the chairman or the secretary of the meeting.

ARTICLE V

Officers

Section 1. Number of Officers. The Corporation's officers shall be a President, one or more Vice Presidents, a Secretary and a Treasurer, and such other officers as may be appointed in accordance with the provisions of Section 3 of this Article. Any two offices or more may be held by one person, except the offices of President and Secretary, but no officer shall sign or execute any document in more than one capacity.

Section 2. Election, Term of Office and Qualifications. Each officer, except such officers as may be appointed in accordance with the provisions of Section 3 of this Article, shall be nominated by the President and elected by the Board and shall hold office until the annual meeting of the Board held next after his election or until his successor shall have been duly elected and qualified or until his death or until he shall resign or shall have been disqualified or shall have been removed from office.

Section 3. Subordinate Officers and Agents. From time to time, the Board of Directors may appoint other officers or agents to hold office for a period, have the authority, and perform duties as the Board of Directors from time to time may determine. The President shall appoint such officers upon notice to the Board. The Board of Directors may delegate to any officer or agent the power to appoint any subordinate officer or agent and to prescribe authority and duties

Section 4. Removal. The officers specifically designated in Section 1 of this Article may be removed, either with or without cause, by vote of a majority of the whole Board at a special meeting of the Board called for that purpose, or by any officer upon whom the Board may confer such power of removal. The officers appointed in accordance with the provisions of Section 3 of this Article may be removed, either with or without cause, by the President. The removal of any person from office shall be without prejudice to the contract rights, if any, of the person so removed..

Section 5. Resignations. Subject to any contract obligations or provisions in this regard, any officer may resign at any time by giving written notice to the Board or to the President or Secretary, or if he were appointed by an officer or agent in accordance with Section 3 of this Article, by giving written notice to the officer or agent who appointed him. Any such resignation shall take effect upon its being accepted by the Board or by the officer or agent appointing the person so resigning.

Section 6. Vacancies. A vacancy in any office because of death, resignation, removal, or disqualification, or any other cause, shall be filled for the unexpired portion of the term in the manner prescribed by these Bylaws for regular appointments or elections to such offices.

Section 7. President. The President shall be the Corporation's chief executive officer and, subject to the Board's instructions, shall have general charge of the Corporation's business, affairs and property and control over its other officers, agents and employees. He shall preside at all meetings of shareholders at which he may be present. The President shall sign, with the Secretary, an Assistant Secretary, or any other proper officer of the Corporation thereunto authorized by the Board, certificates for shares of the Corporation, any deeds, mortgages, bonds, contracts, or other instruments which the Board has authorized

to be executed, except in cases where the signing and execution thereof shall be expressly delegated by the Board or by these Bylaws to some other officer or agent of the Corporation, or shall be required by law to be otherwise signed or executed. The President shall do and perform such other duties as the Board may from time to time assign to him.

Section 8. Vice President. At the President's request, or in the President's absence or disability, the Vice President, and if there be more than one (1) Vice President, the Vice President designated by the Board, or in the absence of such designation, the Vice President designated by the President, or absent such designation, in order of length of service, shall perform all the duties of the President and when so acting shall have all the powers of and be subject to all the restrictions upon the President. The Vice Presidents shall perform such other duties and have such authority as the Board may from time to time assign to them.

Section 9. Secretary. The Secretary shall keep the minutes of the meetings of shareholders and of the Board, and shall see that all notices are duly given in accordance with the provisions of these Bylaws or the Act. He shall be custodian of the Corporation's records, books, reports, statements, certificates and other documents and of the Corporation's seal, and see that the seal is affixed to all share certificates prior to their issuance and to all documents requiring such seal. In general, he shall perform all duties and possess all authority incident to the office of Secretary, and he shall perform such other duties and have such other authority as the Board may from time to time assign to him.

Section 10. Assistant Secretary. In the absence of the Secretary or in the event of his death, inability, or refusal to act, any Assistant Secretary, if such an officer is appointed by the Board, shall, unless otherwise determined by the Board, perform the duties of the Secretary, and when so acting shall have all the powers of and be subject to all the restrictions upon the Secretary. An Assistant Secretary shall perform such other duties as may be assigned to him by the Secretary, by the President, or by the Board. Any Assistant Secretary may sign, with the President or Vice President, certificates for shares of the Corporation.

Section 11. Treasurer. The Treasurer shall have supervision over the Corporation's funds, securities, receipts and disbursements of the Corporation. He shall keep full and accurate accounts of the Corporation's finances in books especially provided for that purpose, and he shall cause a true statement of its assets and liabilities, as of the close of each fiscal year, and of the results of its operations and of changes in surplus for such fiscal year, all in reasonable detail, to be made and filed at the Corporation's principal office within four months after the end of such fiscal year. The statement so filed shall be kept available for inspection by any shareholder for a period of ten years and the Treasurer shall mail or otherwise deliver a copy of the latest such statement to any shareholder upon his written request for the same. He shall in general perform all duties and have all authority incident to the office of Treasurer and shall perform such other duties and have such other authority as the Board may from time to time assign or grant to him.

Section 12. Duties of Officers May Be Delegated. In case of the absence of any officer of the Corporation or for any other reason that the Board may deem sufficient, the Board may delegate the powers or duties of such officer to any other officer or to any Director for the time being provided a majority of the entire Board concurs therein.

Section 13. Salaries of Officers. No officer shall be prevented from receiving a salary as such officer or from voting thereon by reason of the fact that he is also a Director. The Compensation

Committee of the Board shall from time to time fix the salary of the President, subject to ratification by the Board. The President shall recommend the salaries of the Corporation's other officers specifically designated in Section 1, which are subject to approval of the Compensation Committee of the Board. The Board may delegate to any officer who has been given power to appoint subordinate officers or agents, as provided in Section 3 of this Article, the authority to fix the salaries or other compensation of any such officers or agents appointed by him.

Section 14. Bonds. Each officer and employee of the Corporation shall give bond to the Corporation, in a suitable amount to be approved by the Board, conditioned upon the faithful performance of the duties of his respective office or position, and to comply with such other conditions as may from time to time be required by the Board.

ARTICLE VI

Contracts, Loans, Deposits, Checks, Drafts, Etc.

Section 1. Contracts. The Board may authorize any officer or officers, agent or agents to enter into any contract or to execute or deliver any instrument on behalf of the Corporation, and such authority may be general or confined to specific instances.

Section 2. Loans. No loans shall be contracted on the Corporation's behalf and no evidences of indebtedness shall be issued in its name, unless and except as authorized by resolution of the Board. Any officer or agent of the Corporation thereunto so authorized may effect loans or advances for the Corporation and for such loans and advances may make, execute and deliver promissory notes, bonds, or other evidences of indebtedness of the Corporation. Any such officer or agent, when thereunto so authorized, may mortgage, pledge, hypothecate or transfer as security for the payment of any and all loans, advances, indebtedness and liabilities of the Corporation any real property and all stocks, bonds, other securities and other personal property at any time held by the Corporation, and to that end may endorse, assign and deliver the same, and do every act and thing necessary or proper in connection therewith. Such authority may be general or confined to specific instances.

Section 3. Deposits. All corporate funds shall be deposited from time to time to the Corporation's credit in such banks or trust companies or with such bankers or other depositories as the Board may select, or as may be selected by any corporate officer or officers, agent or agents to whom the Board may give such power from time to time.

Section 4. Checks, Drafts, Etc. All notes, drafts, acceptances, checks and endorsements or other evidences of indebtedness shall be signed by the President or a Vice President and by the Secretary or the Treasurer, or in such other manner as the Board from time to time may determine. Endorsements for deposit to the Corporation's credit in any of its duly authorized depositories shall be made by the President or Treasurer or by any officer or agent who may be designated by Board resolution in such manner as such resolution may provide.

ARTICLE VII

Share Certificates and Their Transfer

Section 1. Share Certificates. Share certificates of the Corporation shall be in such form as the Board may approve from time to time. The Corporation shall issue and deliver to each shareholder certificates representing all fully paid shares owned by him. They shall be signed by the President or a Vice President and by the Secretary, Assistant Secretary, or the Treasurer and sealed with the Corporation's seal, which seal may be a facsimile, engraved or printed. All shares shall be consecutively numbered or otherwise identified.

Section 2. Transfers of Shares. The Secretary shall keep books containing the names, alphabetically arranged, of all shareholders of the Corporation, and showing their address, the number and class of shares held by them respectively, the date of issue of such shares, the time when they respectively became the owners thereof and the amount paid thereon. Transfers of the Corporation's shares shall be made on such books at the direction of the record holder thereof or his attorney thereunto duly authorized by a power of attorney thereunto duly executed and filed with the Secretary, or with the transfer agent, if any, for such shares, and the surrender of the certificate or certificates for such shares properly endorsed.

Section 3. Lost or Destroyed Certificates. The Board may authorize the issuance of a new share certificate in place of a certificate theretofore issued by the Corporation claimed to have been lost or destroyed, upon receipt of an affidavit to such fact from the person claiming the loss or destruction. The Board in its discretion may require the owner of the certificate alleged to have been lost, destroyed, stolen or mutilated, or his legal representative, to give the Corporation and its transfer agent and its registrar, if any, before the issuance of such new certificate, a bond of indemnity in such sum and in such form and with such surety or sureties as the Board may direct or the Board, by resolution reciting that the circumstances justify such action, may authorize the issuance of such new certificate without requiring such bond.

Section 4. Regulations. The Board may make such rules and regulations as it may deem expedient concerning the issuance and transfer of certificates for the Corporation's shares and may appoint transfer agents or registrars, or both, and may require all certificates of stock to bear the signature of either or both.

Section 5. Fixing Record Date. (a) The Board may fix a future date as the record date in order to determine (i) the shareholders entitled to notice of a meeting of shareholders, (ii) the shareholders entitled to demand a special meeting, (iii) the shareholders entitled to vote, or (iv) the shareholders entitled to take any other action. A record date fixed under this Section may not be more than seventy (70) days before the meeting or action requiring a determination of shareholders.

(b) A determination of shareholders entitled to notice of or to vote at a meeting of shareholders is effective for any adjournment of the meeting unless the Board fixes a new record date for the adjourned meeting, which it must do if the meeting is adjourned to a date more than one hundred twenty (120) days after the date fixed for the original meeting.

Section 6. Holder of Record. The Corporation may treat as absolute owner of shares the person in whose name the shares stand of record on its books just as if that person has full competency, capacity and authority to exercise all rights of ownership irrespective of any knowledge or notice to the contrary or any description indicating a representative, pledge or other fiduciary relation or any reference to any other instrument or to the rights of any other person appearing upon its record or upon the share certificate, except that any person furnishing to the Corporation proof of his appointment as a fiduciary shall be

treated as if he were a holder of record of its shares, and except as may otherwise by expressly provided by the laws of the State.

Section 7. Reacquired Shares. Shares of the Corporation that have been issued and thereafter reacquired by the Corporation shall constitute authorized but unissued shares.

ARTICLE VIII

General Provisions

Section 1. Corporate Seal. The corporate seal shall be in such form as the Board may approve from time to time.

Section 2. Distributions. The Board from time to time may authorize, and the Corporation may pay, distributions and share dividends on the Corporation's outstanding shares in the manner and upon the terms and conditions provided by law and by the Articles.

Section 3. Fiscal Year. The Corporation's fiscal year shall be the year ending December 31 of each year.

Section 4. Waiver of Notice. Whenever any notice is required to be given to any shareholder or director under the Act, the Articles or these Bylaws, a waiver thereof in writing signed by the person or persons entitled to such notice, whether before or after the time stated therein, shall be equivalent to the giving of such notice.

Section 5. Amendments. Except as otherwise herein provided, these Bylaws may be amended or repealed and new Bylaws may be adopted by the affirmative vote of a majority of the directors then holding office at any regular or special Board meeting. The Board shall not have power to adopt a Bylaw: (a) requiring more than a majority of the voting shares for a quorum at a shareholders' meeting or more than a majority of the votes cast to constitute action by the shareholders, except where higher percentages are required by law; or (b) providing for the management of the Corporation other than by the Board or its Executive Committee. The shareholders may make, alter, amend or repeal the Corporation's Bylaws at any annual meeting or at a special meeting called for such purpose, and Bylaws adopted by the directors may be altered or repealed by the shareholders. No Bylaw adopted or amended by the shareholders shall be altered or repealed by the Board, unless specific authority to do so is provided to the Board by the shareholders.

Section 6. Indemnification. The Corporation shall, to the fullest extent from time to time permitted by law, indemnify (a) all directors, officers, employees or agents of the Corporation and (b) any person who, at the Corporation's request, is or was serving as a director, officer, partner, trustee, employee or agent of another Corporation, partnership, joint venture, trust or other enterprise or as a trustee or administrator under an employee benefit plan, against liability and expenses in any proceeding (including without limitation a proceeding brought by or on behalf of the Corporation itself) arising out of their status as such or their activities in any of the foregoing capacities ("Indemnified Person"); provided, however, that the Corporation shall not indemnify or agree to indemnify an Indemnified Person against liability or expenses he may incur on account of his activities which were at the time taken known or believed by him to be clearly in conflict with the Corporation's best interests.

The term "Indemnified Person" shall specifically include all persons who were initial directors, officers or employees of the Corporation prior to its incorporation and the Corporation shall, to the fullest extent from time to time permitted by law, indemnify such Indemnified Persons against liability and expenses in any proceeding arising out of their status as such or their activities on behalf of the Corporation prior to its incorporation.

The Corporation may pay in advance expenses incurred by an Indemnified Person in defending a proceeding in advance of the final disposition of such proceeding as authorized by the Board in the specific case or as authorized or required under any provision in the Articles or these bylaws or by any applicable resolution or contract, upon receipt of an undertaking by or on behalf of such Indemnified Person to repay such amount unless it shall ultimately be determined that he is entitled to be indemnified by the Corporation against such expenses.

The Corporation shall also pay or indemnify an Indemnified Person for such person’s reasonable costs, expenses and reasonable attorney’s fees in connection with the enforcement of rights to indemnification granted herein.

The Board shall take all such action as may be necessary and appropriate to authorize the Corporation to pay the indemnification required by this bylaw, including without limitation a determination by a majority vote of disinterested directors that the activities giving rise to the liability or expense for which indemnification is requested were not, at the time taken, known or believed by the person requesting indemnification to be clearly in conflict with the best interests of the Corporation.

The Corporation may purchase and maintain insurance on behalf of an Indemnified Person against liability asserted against or incurred by him in that capacity or arising from his status, whether or not the Corporation would have the power to indemnify him against the same liability under any provision of these Bylaws.

The provisions of this section are subject to the following provisions:

(a) the termination of any action, suit, or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that any such Indemnified Person did not meet any requisite standard of conduct imposed by law in order to be entitled to such indemnification;

(b) in the event of such Indemnified Person’s death, the rights to indemnification hereunder shall extend to his or her legal representative; and

(c) the rights to indemnification hereunder shall be in addition to and not exclusive of any other rights to which any such Indemnified Person may be entitled under any statute, agreement, insurance policy, or otherwise.

For the purposes of this section, "liability" means any obligation to pay a judgment, settlement, penalty, fine (including an excise tax assessed with respect to an employee benefit plan), or reasonable expenses incurred with respect to a proceeding, "expenses" means expenses of every kind incurred in defending a proceeding, including counsel fees, and "proceeding" means any threatened, pending, or

completed action, suit or proceeding, whether civil, criminal, administrative or investigative and whether formal or informal.

Section 7. Interpretation of Bylaws.

(a) All references in these Bylaws to directors, officers, shares and shareholders are references to directors, officers, shares and shareholders of the Corporation and the Board, unless the context clearly indicates otherwise.

(b) The following terms, as used in these Bylaws, shall have the following meanings, unless the context clearly indicates otherwise:

"Act" means the North Carolina Business Corporation Act, North Carolina General Statutes, Chapter 55.

"Articles" means the Corporation's Articles of Incorporation.

"Corporation" shall mean Gateway Financial Holdings, Inc., a North Carolina corporation.

"Board" means the Corporation 's Board of Directors.

"State" shall mean the state of North Carolina.

Section 5: EX-10.4 (EXHIBIT 10.4)

EMPLOYMENT AGREEMENT

THIS AMENDED AGREEMENT is entered into as of October 1, 2007, by and between **GATEWAY BANK & TRUST COMPANY,** a North Carolina banking corporation (hereinafter referred to as the "Bank") and **DANIEL B. BERRY** of Virginia Beach, Virginia (hereinafter referred to as the "Officer").

For and in consideration of their mutual promises, covenants and conditions hereinafter set forth, and other good and valuable consideration, the receipt and sufficiency of which hereby is acknowledged, the parties agree as follows:

1. **Employment**. The Bank agrees to employ the Officer and the Officer agrees to accept employment upon the terms and conditions stated herein as Chief Executive Officer of the Bank. The Officer shall render such administrative and management services to the Bank as are customarily performed by persons situated in a similar executive capacity. The Officer shall promote the business of the Bank and perform such other duties as shall, from time to time, be reasonably assigned by the Board of Directors of the Bank (the "Directors"). Upon the request of the Directors, the Officer shall disclose all business activities or commercial pursuits in which Officer is engaged, other than Bank duties.

2. **Compensation**. The Bank shall pay the Officer during the term of this Agreement, as compensation for all services rendered by the Officer to the Bank, a base salary at the rate of $525,000 per annum, payable in cash not less frequently than monthly. The rate of such salary shall be reviewed by the Compensation Committee of the Board of Directors of the Bank (the "Committee") not less often than annually and the Committee may increase, but shall not decrease, such rate during the term of this Agreement. Such rate of salary, or increased rate of salary, as the case may be, may be further increased from time to time in such amounts as the Committee, in its discretion, may decide. In determining salary increases, the Committee shall compensate the Officer for increases in the cost of living and may also provide for performance or merit increases. Participation in the Bank’s incentive compensation, deferred compensation, discretionary bonus, profit-sharing, retirement and other employee benefit plans and participation in any fringe benefits shall not reduce the salary payable to the Officer under this Paragraph. In the event of a Change in Control (as defined in Paragraph 10), the Officer’s rate of salary shall be increased not less than five percent annually during the term of this Agreement. Any payments made under this Agreement shall be subject to such deductions as are required by law or regulation or as may be agreed to by the Bank and the Officer.

3. **Discretionary Bonuses**. During the term of this Agreement, the Officer shall be entitled to such discretionary bonuses as may be authorized, declared and paid by the Committee to the Bank’s key management employees. No other compensation provided for in this Agreement shall be deemed a substitute for the Officer’s right to such discretionary bonuses when and as declared by the Committee.

4. **Participation in Retirement and Employee Benefit Plans; Fringe Benefits.**

(a) The Bank shall provide family medical coverage and disability insurance for the Officer and the Officer shall also be entitled to participate in any plan relating to deferred compensation, stock options, stock purchases, pension, thrift, profit sharing, group life insurance, education, or other retirement or employee benefits that the Bank has adopted, or may, from time to time adopt, for the benefit of its executive employees or for employees generally, subject to the eligibility rules of such plans.

(b) The Bank shall pay the expenses of the Officer for membership in two country clubs and one health club in the market area of the Bank at the Officer’s election and dues for membership in civic

clubs. The Bank shall also provide the Officer with the use of a late model automobile suitable to the status of the Officer of a type and for lease terms to be approved by the Committee.

(c) The Officer shall also be entitled to participate in any other fringe benefits which are now or may be or become applicable to the Bank's executive employees, including the payment of reasonable expenses for attending annual and periodic meetings of trade associations, and any other benefits which are commensurate with the duties and responsibilities to be performed by the Officer under this Agreement. Additionally, the Officer shall be entitled to such vacation and sick leave as shall be established under uniform employee policies promulgated by the Directors. The Bank shall reimburse the Officer for all out-of-pocket reasonable and necessary business expenses that the Officer may incur in connection with the Officer's services on behalf of the Bank.

(d) After Officer's employment with the Bank is terminated for any reason other than Cause (as defined in Paragraph 8), the Bank shall continue to provide medical insurance coverage to the Officer and Officer's spouse for the lifetime of each, either, in the Bank's discretion, as part of the Bank's group medical insurance plan for active employees or through individual medical insurance policies. Notwithstanding the foregoing, as of the first date that (i) the Officer is no longer employed by the Bank and (ii) the Officer and Officer's spouse, respectively, have attained sixty-five (65) years of age, the Bank shall be obligated only to provide such individual with supplemental Medicare health insurance in order to meet its obligations under this Paragraph 4(d). The Bank shall be responsible for paying directly all of the premiums required to meet its obligations under this Paragraph 4(d).

5. **Term**. The initial term of employment under this Agreement shall be for the period commencing upon March 1, 2006 and ending three calendar years from that date. On each anniversary of the commencement of the term of this Agreement, the term of this Agreement shall automatically be extended for an additional one-year period beyond the then effective expiration date unless written notice from the Bank or the Officer is received 90 days prior to an anniversary date advising the other that this Agreement shall not be further extended; provided that the Committee shall review the Officer's performance annually and make a specific determination pursuant to such review to renew this Agreement prior to the 90 days' notice.

6. **Loyalty; Noncompetition.**

(a) The Officer shall devote his full efforts and entire business time to the performance of the Officer's duties and responsibilities under this Agreement.

(b) During the term of this Agreement, or any renewals thereof, and for a period of one year after termination, the Officer agrees he will not, within the "Restricted Area," directly or indirectly, engage in any business that competes with the Bank or any of its subsidiaries without the prior written consent of the Bank; provided, however, that the provisions of this Paragraph shall not apply in the event the Officer's employment is unilaterally terminated by the Bank for Cause, (as such term is defined in Paragraph 8(c) hereof) or in the event the Officer terminates his employment with the Bank after the occurrence of a "Termination Event" (as such term is defined in Paragraph 10(b) hereof) following a "Change of Control" (as such term is defined in Paragraph 10(d) hereof). The Restricted Area covers the following divisible list of territories: Camden, Chowan, Currituck, Dare, Pasquotank, and Perquimans Counties, North Carolina and Chesapeake and Virginia Beach, Virginia, and within 15 miles of any Bank office operated during the term of this Agreement. The one-year restricted period, however, does not include any period of violation or period of time required for litigation to enforce the Officer's agreement not to compete against the Bank. Notwithstanding the foregoing, the Officer shall be free, without such consent, to purchase or hold as an investment or otherwise, up to five percent of the outstanding stock or other security of any corporation which has its securities publicly traded on any recognized securities exchange or in any over-the counter market.

(c) The Officer agrees he will hold in confidence all knowledge or information of a confidential nature with respect to the business of the Bank or any subsidiary received by the Officer during the term of this Agreement and will not disclose or make use of such information without the prior written consent of the Bank. The Officer agrees that he will be liable to the Bank for any damages caused by unauthorized disclosure of such information. Upon termination of his employment, the Officer agrees to return all records or copies thereof of the Bank or any subsidiary in his possession or under his control which relate to the activities of the Bank or any subsidiary.

(d) The Officer acknowledges that it would not be possible to ascertain the amount of monetary damages in the event of a breach by the Officer under the provisions of this Paragraph 6. The Officer agrees that, in the event of a breach of this Paragraph 6, injunctive relief enforcing the terms of this Paragraph 6 is an appropriate remedy. If the scope of any restriction contained in this Paragraph 6 is determined to be too broad by any court of competent jurisdiction, then such restriction shall be enforced to the maximum extent permitted by law and the Officer consents that the scope of this restriction may be modified judicially.

7. **Standards**. The Officer shall perform his duties and responsibilities under this Agreement in accordance with such reasonable standards expected of employees with comparable positions in comparable organizations and as may be established from time to time by the Directors. The Bank will provide the Officer with the working facilities and staff customary for similar executives and necessary for the Officer to perform his duties.

8. **Termination and Termination Pay.** (a) The Officer’s employment under this Agreement shall be terminated upon the death of the Officer during the term of this Agreement, in which event, the Officer’s estate shall be entitled to receive the compensation due the Officer through the last day of the calendar month in which the Officer’s death shall have occurred and for a period of one month thereafter.

(b) The Officer’s employment under this Agreement may be terminated at any time by the Officer upon 60 days’ written notice to the Directors. Upon such termination, the Officer shall be entitled to receive compensation through the effective date of such termination.

(c) The Directors may terminate the Officer’s employment at any time, but any termination by the Directors, other than termination for Cause, shall not prejudice the Officer’s right to compensation or other benefits under this Agreement. The Officer shall not be deemed to have been terminated for Cause unless and until the Directors approve a resolution, which shall (1) contain a finding that, in the good faith opinion of the Directors, the Officer has committed an act or acts constituting Cause, and (2) specify the particulars constituting Cause. The resolution shall have been duly adopted by the affirmative vote of all the directors of the Bank then in office, excluding the Officer, at a meeting duly called and held for that purpose. Notice of the meeting and a draft of the proposed resolution approving termination for Cause shall be given to the Officer a reasonable amount of time before the meeting of the Directors. The Officer and his counsel (if the Officer chooses to have counsel present) shall have a reasonable opportunity to be heard by the Directors at the meeting. Nothing in this Agreement limits the Officer’s or his beneficiaries’ right to contest the validity or propriety of the determination of Cause by the Directors. Upon termination for Cause, the Executive shall not be entitled to any further compensation or other benefits beyond his effective termination date, except any benefits to which he may be entitled under the Bank’s benefit plans and policies in effect on the date of termination or such benefits which by the terms of the plan document continue after such termination. For purposes of this Employment Agreement, "Cause" means any of the following:

(i) an intentional act of fraud, embezzlement, or theft by the Officer in the course of his employment. For purposes of this Agreement, no act or failure to act on the part of the Officer shall be deemed to have been intentional if it was due primarily to an error in judgment or

negligence. An act or failure to act on the Officer's part shall be considered intentional if it was not in good faith and if it was without a reasonable belief that the action or failure to act was in the best interests of the Bank; or

(ii) intentional misconduct of the Officer, which in the reasonable judgment of the Directors has a material adverse effect on, or causes material harm to, the Bank, including, without limitation, the reputation of the Bank; or

(iii) the Officer's willful and repeated refusal to perform material duties or gross negligence in the performance of his duties to the Bank; or

(iv) a breach by the Officer of his fiduciary duties as an officer or director of the Bank or Gateway Financial Holdings, Inc., in either case, whether in his capacity as an officer or as a director of the Bank or Gateway Financial Holdings, Inc.; or

(v) a breach by the Officer of this Agreement that, in the reasonable judgment of the Directors, is a material breach, which breach is not corrected by the Officer within 30 days after receiving written notice of the breach from the Directors; or

(vi) removal of the Officer from office or permanent prohibition of the Officer from participating in the Bank's affairs by an order issued under section 8(e) (4) or (g) (1) of the Federal Deposit Insurance Act, 12 U.S.C. 1818(e) (4) or (g)(1); or

(vii) conviction of the Officer for or plea of *nob contendere* to a felony or the actual incarceration of the Officer.

Notwithstanding such termination, the obligations under Paragraph 6(c) shall survive any termination of employment.

(d) Subject to the Bank's obligations and the Officer's rights under (i) Title I of the Americans with Disabilities Act, §504 of the Rehabilitation Act, and the Family and Medical Leave Act, and to (ii) the vacation leave, disability leave, sick leave and any other leave policies of the Bank, the Officer's employment under this Agreement automatically shall be terminated in the event the Officer becomes disabled during the term of this Agreement and it is determined by the Bank that the Officer is unable to perform the essential functions of the Officer's job under this Agreement for ninety (90) business days or more during any 12-month period. Upon any such termination, the Officer shall be entitled to receive any compensation the Officer shall have earned prior to the date of termination but which remains unpaid, and shall be entitled to any payments provided under any disability income plan of the Bank which is applicable to the Officer.

In the event of any disagreement between the Officer and the Bank as to whether the Officer is physically or mentally incapacitated such as will result in the termination of the Officer's employment pursuant to this Paragraph 8(d), the question of such incapacity shall be submitted to an impartial physician licensed to practice medicine in North Carolina for determination and who will be selected by mutual agreement of the Officer and the Bank, or failing such agreement, by two (2) physicians (one (1) of whom shall be selected by the Bank and the other by the Officer), and such determination of the question of such incapacity by such physician or physicians shall be final and binding on the Officer and the Bank. The Bank shall pay the reasonable fees and expenses of such physician or physicians in making any determination required under this Paragraph 8(d).

9. **Additional Regulatory Requirements.** Notwithstanding anything contained in this Agreement to the contrary, it is understood and agreed that the Bank (or any of its successors in interest) shall not be required to make any payment or take any action under this Agreement if:

(a) such payment or action is prohibited by any governmental agency having jurisdiction over the Bank (hereinafter referred to as "Regulatory Authority") because the Bank is declared by such Regulatory Authority to be insolvent, in default or operating in an unsafe or unsound manner; or,

(b) in the reasonable opinion of counsel to the Bank, such payment or action (i) would be prohibited by or would violate any provision of state or federal law applicable to the Bank, including,

without limitation, the Federal Deposit Insurance Act as now in effect or hereafter amended, (ii) would be prohibited by or would violate any applicable rules, regulations, orders or statements of policy, whether now existing or hereafter promulgated, of any Regulatory Authority, or (iii) otherwise would be prohibited by any Regulatory Authority.

10. **Change in Control.** (a) In the event of a termination of the Officer's employment in connection with, or within twenty-four (24) months after, a "Change in Control" (as defined in Subparagraph (d) below) other than for Cause (as defined in Paragraph 8), the Officer shall be entitled to receive the amount set forth in Subparagraph (c) below. Said sum shall be payable as provided in Subparagraph (e) below.

(b) In addition to any rights the Officer might have to terminate this Agreement contained in Paragraph 8, the Officer shall have the right to terminate this Agreement upon the occurrence of any of the following events (the "Termination Events") within twenty-four months following a Change in Control:

(i) Officer is assigned any duties and/or responsibilities that, in Officer's reasonable determination, are inconsistent with or constitute a demotion or reduction in the Officer's position, duties, responsibilities or status as such existed at the time of the Change in Control or with his reporting responsibilities or titles with the Bank in effect at such time, regardless of Officer's resulting position; or

(ii) Officer's annual base salary rate is reduced below the annual amount in effect as of the effective date of a Change in Control or as the same shall have been increased from time to time following such effective date; or

(iii) Officer's life insurance, medical or hospitalization insurance, disability insurance, stock options plans, stock purchase plans, deferred compensation plans, management retention plans, retirement plans or similar plans or benefits being provided by the Bank to the Officer as of the effective date of the Change in Control are reduced in their level, scope or coverage, or any such insurance, plans or benefits are eliminated, unless such reduction or elimination applies proportionately to all salaried employees of the Bank who participated in such benefits prior to such Change in Control; or

(iv) Officer is transferred to a location which is more than 15 miles from his current principal work location without the Officer's express written consent.

A Termination Event shall be deemed to have occurred on the date such action or event is implemented or takes effect.

(c) In the event that the Officer's employment is terminated pursuant to this Paragraph 10, the Bank will be obligated to pay or cause to be paid to Officer an amount equal to 2.99 times the Officer's "base amount" as defined in Section 280G(b)(3) of the Internal Revenue Code of 1986, as amended (the "Code").

(d) For the purposes of this Agreement, the term Change in Control shall mean any of the following events:

(i) Any person, or more than one person acting as a group, accumulates ownership of the common stock of Gateway Financial Holdings, Inc. ("Gateway Financial") constituting more than 50% of the total fair market value or total voting power of Gateway Financial's common stock,

(ii) Any person, or more than one person acting as a group, acquires within a 12-month period ownership of Gateway Financial's common stock possessing 30% or more of the total voting power of Gateway Financial's common stock;

(iii) A majority of Gateway Financial's Board of Directors is replaced during any 12-month period by directors whose appointment or election is not endorsed in advance by a majority of Gateway Financial's Board of Directors before the date of appointment or election, or

(iv) Within a 12-month period, any person, or more than one person acting as a group, acquires assets from Gateway Financial having a total gross fair market value equal to or exceeding 40% of the total gross fair market value of all of the assets of Gateway Financial immediately before the acquisition or acquisitions. For this purpose, "gross fair market value" means the value of Gateway Financial's assets, or the value of the assets being disposed of, determined without regard to any liabilities associated with the assets

Persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase, or acquisition of stock, or a similar transaction, involving Gateway Financial. Notwithstanding the other provisions of this Paragraph 10, a transaction or event shall not be considered a Change in Control if, prior to the consummation or occurrence of such transaction or event, the Officer and Bank agree in writing that the same shall not be treated as a Change in Control for purposes of this Agreement.

(e) Such amounts payable pursuant to this Paragraph 10 shall be paid, at the option of the Officer, either in one lump sum or in thirty-six (36) equal monthly payments following termination of Officer's employment.

(f) Following a Termination Event which gives rise to Officer's rights hereunder, the Officer shall have twelve (12) months from the date of occurrence of the Termination Event to terminate this Agreement pursuant to this Paragraph 10. Any such termination shall be deemed to have occurred only upon delivery to the Bank (or to any successor corporation) of written notice of termination which describes the Change in Control and the Termination Event. If Officer does not so terminate this Agreement within such twelve-month period, he shall thereafter have no further rights hereunder with respect to that Termination Event, but shall retain rights, if any, hereunder with respect to any other Termination Event as to which such period has not expired.

(g) If the Officer receives the payment pursuant to this Paragraph 10 and acceleration of benefits under any other benefit, compensation, or incentive plan or arrangement with the Bank or its parent corporation (collectively, the "Total Benefits"), and if any part of the Total Benefits is subject to an excise tax under Section 280G and Section 4999 of the Code (the "Excise Tax"), the Bank shall pay to the Officer the following additional amounts, consisting of (*x*) a payment equal to the Excise Tax payable by the Officer under section 4999 on the Total Benefits (the "Excise Tax Payment") and (*y*) a payment equal to the amount necessary to provide the Excise Tax Payment net of all income, payroll, and excise taxes. Together, the additional amounts described in clauses (*x*) and (*y*) are referred to in this Agreement as the "Gross-Up Payment Amount." Payment of the Gross-Up Payment Amount shall be made in addition to the amount set forth in Subparagraph 10(c) above.

For purposes of determining whether any of the Total Benefits will be subject to the Excise Tax and for purposes of determining the amount of the Excise Tax, any other payments or benefits received or to be received by the Officer in connection with a Change in Control or the Officer's termination of employment following a Change in Control (whether under the terms of this Agreement or any other agreement or any other benefit plan or arrangement with the Bank or its parent corporation) shall be treated as "parachute payments" within the meaning of section 280G(b)(2) of the Code, and all "excess parachute payments" within the meaning of section 280G(b)(1) shall be treated as subject to the Excise Tax, unless in the opinion of the certified public accounting firm that is retained by the Bank as of the date immediately before the Change in Control (the "Accounting Firm"), such other payments or benefits do not constitute (in whole or in part) parachute payments, or such excess parachute payments represent (in whole or in part) reasonable compensation for services actually rendered within the meaning of section 280G(b)(4) of the Code in excess of the "base amount" (as defined in section 280G(b)(3) of the Code), or are otherwise not subject to the Excise Tax. The value of any noncash benefits or any deferred payment or benefit shall be determined by the Accounting Firm in accordance with the principles of sections 280G (d)(3) and (4) of the Code.

For purposes of determining the Gross-Up Payment Amount, the Officer shall be deemed to pay federal income taxes at the highest marginal rate of federal income taxation in the calendar years in which the Gross-Up Payment Amount is to be made and state and local income taxes at the highest marginal rate of taxation in the state and locality of the Officer’s residence on the date of termination of employment, net of the reduction in federal income taxes that can be obtained from deduction of such state and local taxes (calculated by assuming that any reduction under section 68 of the Code in the amount of itemized deductions allowable to the Officer applies first to reduce the amount of such state and local income taxes that would otherwise be deductible by the Officer, and applicable federal FICA and Medicare withholding taxes).

All determinations required to be made under this Subparagraph, including whether and when a Gross-Up Payment Amount is required, the amount of the Gross-Up Payment Amount and the assumptions to be used to arrive at the determination (collectively, the "Determination"), shall be made by the Accounting Firm, which shall provide detailed supporting calculations both to the Bank and the Officer within 15 business days after receipt of notice from the Bank or the Officer that there has been a Gross-Up Payment Amount, or such earlier time as is requested by the Bank. All fees and expenses of the Accounting Firm shall be borne solely by the Bank. The Bank shall enter into any reasonable agreement requested by the Accounting Firm in connection with the performance of its services hereunder. If the Accounting Firm determines that no Excise Tax is payable by the Officer, the Accounting Firm shall furnish the Officer with a written opinion to that effect, and to the effect that failure to report an Excise Tax, if any, on the Officer’s applicable federal income tax return will not result in the imposition of a negligence or similar penalty.

The Determination by the Accounting Firm shall be binding on the Bank and the Officer. If, after a Determination by the Accounting Firm, the Officer is required to make a payment of additional Excise Tax ("Underpayment"), the Accounting Firm shall determine the amount of the Underpayment that has occurred. The Underpayment (together with interest at the rate provided in section 1274(d)(2)(B) of the Code) shall be paid promptly by the Bank to or for the benefit of the Officer. If the Gross-Up Payment Amount exceeds the amount necessary to reimburse the Officer for his Excise Tax ("Overpayment"), the Accounting Firm shall determine the amount of the Overpayment that has been made. The Overpayment (together with interest at the rate provided in section 1274(d)(2)(B) of the Code) shall be paid promptly by the Officer to or for the benefit of the Bank. Provided that his expenses are reimbursed by the Bank, the Officer shall cooperate with any reasonable requests by the Bank in any contests or disputes with the Internal Revenue Service relating to the Excise Tax.

If the Accounting Firm is serving as accountant or auditor for the individual, entity, or group effecting the Change in Control, the Officer, in his sole discretion, may appoint another nationally recognized public accounting firm to make the Determinations required hereunder (in which case the term "Accounting Firm" as used in this Employment Agreement shall be deemed to refer to the accounting firm appointed by the Officer under this Subparagraph).

(h) In the event any dispute shall arise between the Officer and the Bank as to the terms or interpretation of this Agreement, including this Paragraph 10, whether instituted by formal legal proceedings or otherwise, including any action taken by the Officer to enforce the terms of this Paragraph 10 or in defending against any action taken by the Bank, the Bank shall reimburse the Officer for all costs and expenses, proceedings or actions, in the event the Officer prevails in any such action.

11. **Successors and Assigns.** (a) This Agreement shall inure to the benefit of and be binding upon any corporate or other successor of the Bank which shall acquire, directly or indirectly, by conversion, merger, purchase or otherwise, all or substantially all of the assets of the Bank.

(b) Since the Bank is contracting for the unique and personal skills of the Officer, the Officer shall be precluded from assigning or delegating his rights or duties hereunder without first obtaining the written consent of the Bank.

12. **Modification; Wavier; Amendments**. No provision of this Agreement may be modified, waived or discharged unless such waiver, modification or discharge is agreed to in writing, signed by the Officer and on behalf of the Bank by such officer as may be specifically designated by the Board of Directors. No waiver by either party hereto, at any time, of any breach by the other party hereto of, or compliance with, any condition or provision of this Agreement to be performed by such other party shall be deemed a waiver of similar or dissimilar provisions or conditions at the same or at any prior or subsequent time. No amendment or addition to this Agreement shall be binding unless in writing and signed by both parties, except as herein otherwise provided.

13. **Applicable Law**. This Agreement shall be governed in all respects whether as to validity, construction, capacity, performance or otherwise, by the laws of North Carolina, except to the extent that federal law shall be deemed to apply.

14. **Severability**. The provisions of this Agreement shall be deemed severable and the invalidity or unenforceability of any provision shall not affect the validity or enforceability of the other provisions hereof.

15. **Previous Agreement**. This Agreement replaces the previous employment agreement between the Officer and the Bank, which established the non-competition covenant in consideration of Officer's employment by the Bank. The Officer acknowledges that the payment of dues of an additional country club and a health club membership in Paragraph 4(b) and the substitution of this Agreement for the previous agreement constitute sufficient and adequate consideration for the covenants in Paragraph 6 of this Agreement. The Officer further acknowledges, by execution of this Amended Agreement, that the amendments to this Agreement have no effect on, and the Officer reaffirms and ratifies, the covenants in Paragraph 6 of this Agreement.

IN WITNESS WHEREOF, the parties have amended this Agreement as of the day and year first hereinabove written.

GATEWAY BANK & TRUST CO.

By: /s/ David R. Twiddy
David R. Twiddy, President

Attest:

/s/ Wendy W. Small
Corporate Secretary

OFFICER

/s/ D. Ben Berry [SEAL]
D. Ben Berry

Section 6: EX-10.5 (EXHIBIT 10.5)

Exhibit 10.5

EMPLOYMENT AGREEMENT

THIS AMENDED AGREEMENT is entered into as of October 1, 2007 by and between **GATEWAY BANK & TRUST CO.,** a North Carolina banking corporation (hereinafter referred to as the "Bank") and **DAVID R. TWIDDY**, an individual resident of North Carolina (hereinafter referred to as the "Officer").

For and in consideration of their mutual promises, covenants and conditions hereinafter set forth, and other good and valuable consideration, the receipt and sufficiency of which hereby is acknowledged, the parties agree as follows:

1. **Employment**. The Bank agrees to employ the Officer and the Officer agrees to accept employment upon the terms and conditions stated herein as President of the Bank. The Officer shall render such administrative and management services to the Bank as are customarily performed by persons situated in a similar executive capacity. The Officer shall promote the business of the Bank and perform such other duties as shall, from time to time, be reasonably assigned by the Chief Executive Officer of the Bank. Upon the request of the Chief Executive Officer, the Officer shall disclose all business activities or commercial pursuits in which Officer is engaged, other than Bank duties.

2. **Compensation**. The Bank shall pay the Officer during the term of this Agreement, as compensation for all services rendered by the Officer to the Bank, a base salary at the rate of $375,000 per annum, payable in cash not less frequently than monthly. The rate of such salary shall be reviewed by the Compensation Committee of the Board of Directors of the Bank (the "Committee") not less often than annually and the Committee may increase, but shall not decrease, such rate during the term of this Agreement. Such rate of salary, or increased rate of salary, as the case may be, may be further increased from time to time in such amounts as the Committee, in its discretion, may decide. In determining salary increases, the Committee shall compensate the Officer for increases in the cost of living and may also provide for performance or merit increases. Participation in the Bank's incentive compensation, deferred compensation, discretionary bonus, profit-sharing, retirement and other employee benefit plans and participation in any fringe benefits shall not reduce the salary payable to the Officer under this Paragraph. In the event of a Change in Control (as defined in Paragraph 10), the Officer's rate of salary shall be increased not less than five percent annually during the term of this Agreement. Any payments made under this Agreement shall be subject to such deductions as are required by law or regulation or as may be agreed to by the Bank and the Officer.

3. **Discretionary Bonuses**. During the term of this Agreement, the Officer shall be entitled to such discretionary bonuses as may be authorized, declared and paid by the Committee to the Bank's key management employees. No other compensation provided for in this Agreement shall be deemed a substitute for the Officer's right to such discretionary bonuses when and as declared by the Committee.

4. **Participation in Retirement and Employee Benefit Plans; Fringe Benefits.**

(a) The Bank shall provide family medical coverage and disability insurance for the Officer and the Officer shall also be entitled to participate in any plan relating to deferred compensation, stock options, stock purchases, pension, thrift, profit sharing, group life insurance, education, or other retirement or employee benefits that the Bank has adopted, or may, from time to time adopt, for the benefit of its executive employees or for employees generally, subject to the eligibility rules of such plans.

(b) The Officer shall also be entitled to participate in any other fringe benefits which are now or may be or become applicable to the Bank's executive employees, including the payment of reasonable expenses for attending annual and periodic meetings of trade associations, and any other benefits which are commensurate with the duties and responsibilities to be performed by the Officer under this Agreement. Additionally, the Officer shall be entitled to such vacation and sick leave as shall be established under uniform employee policies promulgated by the Bank. The Bank shall reimburse the Officer for all out-of-pocket reasonable and necessary business expenses which the Officer may incur in connection with the Officer's services on behalf of the Bank.

(c) The Bank shall pay the expenses of the Officer for membership in two country clubs in the market area of the Bank at the Officer's election and dues for membership in civic clubs. The Bank shall also provide the Officer with the use of a late model automobile suitable to the status of the Officer of a type and for lease terms to be approved by the Committee.

(d) After Officer's employment with the Bank is terminated for any reason other than Cause (as defined in Paragraph 8), the Bank shall continue to provide medical insurance coverage to the Officer and Officer's spouse for the lifetime of each, either, in the Bank's discretion, as part of the Bank's group medical insurance plan for active employees or through individual medical insurance policies. Notwithstanding the foregoing, as of the first date that (i) the Officer is no longer employed by the Company and (ii) the Officer and Officer's spouse, respectively, have attained sixty-five (65) years of age, the Bank shall be obligated only to provide such individual with supplemental Medicare health insurance in order to meet its obligations under this Paragraph 4(d). The Bank shall be responsible for paying directly all of the premiums required to meet its obligations under this Paragraph 4(d).

5. **Term**. The initial term of employment under this Agreement shall be for the period commencing upon March 1, 2006 and ending three calendar years from that date. On each anniversary of the commencement of the term of this Agreement, the term of this Agreement shall automatically be extended for an additional one-year period beyond the then effective expiration date unless written notice from the Bank or the Officer is received 90 days prior to an anniversary date advising the other that this Agreement shall not be further extended; provided that the Committee shall review the Officer's performance annually and make a specific determination pursuant to such review to renew this Agreement prior to the 90 days' notice.

6. **Loyalty; Noncompetition; Confidentiality.**

(a) The Officer shall devote his full efforts and entire business time to the performance of the Officer's duties and responsibilities under this Agreement.

(b) During the term of this Agreement, or any renewals thereof, and for a period of one year after termination, the Officer agrees he will not, within the "Restricted Area," directly or indirectly, engage in any business that competes with the Bank or any of its subsidiaries without the prior written consent of the Bank; provided, however, that the provisions of this Paragraph shall not apply in the event the Officer's employment is unilaterally terminated by the Bank for Cause, (as such term is defined in Paragraph 8(c) hereof) or in the event the Officer terminates his employment with the Bank after the occurrence of a "Termination Event" (as such term is defined in Paragraph 10(b) hereof) following a "Change of Control" (as such term is defined in Paragraph 10(d) hereof). The Restricted Area covers the following divisible list of territories: Camden, Chowan, Currituck, Dare, Pasquotank, and Perquimans Counties, North Carolina and Chesapeake and Virginia Beach, Virginia, and within 15 miles of any Bank office operated during the term of this Agreement. The one-year restricted period, however, does not include any period of violation or period of time required for litigation to enforce the Officer's agreement not to compete against the Bank. Notwithstanding the foregoing, the Officer shall be free, without such consent, to purchase or hold as an investment or otherwise, up to five percent of the outstanding stock or

other security of any corporation which has its securities publicly traded on any recognized securities exchange or in any over-the counter market.

(c) The Officer agrees he will hold in confidence all knowledge or information of a confidential nature with respect to the business of the Bank or any subsidiary received by the Officer during the term of this Agreement and will not disclose or make use of such information without the prior written consent of the Bank. The Officer agrees that he will be liable to the Bank for any damages caused by unauthorized disclosure of such information. Upon termination of his employment, the Officer agrees to return all records or copies thereof of the Bank or any subsidiary in his possession or under his control which relate to the activities of the Bank or any subsidiary.

(d) The Officer acknowledges that it would not be possible to ascertain the amount of monetary damages in the event of a breach by the Officer under the provisions of this Paragraph 6. The Officer agrees that, in the event of a breach of this Paragraph 6, injunctive relief enforcing the terms of this Paragraph 6 is an appropriate remedy. If the scope of any restriction contained in this Paragraph 6 is determined to be too broad by any court of competent jurisdiction, then such restriction shall be enforced to the maximum extent permitted by law and the Officer consents that the scope of this restriction may be modified judicially.

7. **Standards**. The Officer shall perform his duties and responsibilities under this Agreement in accordance with such reasonable standards expected of employees with comparable positions in comparable organizations and as may be established from time to time by the Bank. The Bank will provide the Officer with the working facilities and staff customary for similar executives and necessary for the Officer to perform his duties.

8. **Termination and Termination Pay.** (a) The Officer's employment under this Agreement shall be terminated upon the death of the Officer during the term of this Agreement, in which event, the Officer's estate shall be entitled to receive the compensation due the Officer through the last day of the calendar month in which the Officer's death shall have occurred and for a period of one month thereafter.

(b) The Officer's employment under this Agreement may be terminated at any time by the Officer upon 60 days' written notice to the Bank. Upon such termination, the Officer shall be entitled to receive compensation through the effective date of such termination.

(c) The Directors may terminate the Officer's employment at any time, but any termination by the Directors, other than termination for Cause, shall not prejudice the Officer's right to compensation or other benefits under this Agreement. The Officer shall not be deemed to have been terminated for Cause unless and until the Directors approve a resolution, which shall (1) contain a finding that, in the good faith opinion of the Directors, the Officer has committed an act or acts constituting Cause, and (2) specify the particulars constituting Cause. The resolution shall have been duly adopted by the affirmative vote of all the directors of the Bank then in office, excluding the Officer, at a meeting duly called and held for that purpose. Notice of the meeting and a draft of the proposed resolution approving termination for Cause shall be given to the Officer a reasonable amount of time before the meeting of the Directors. The Officer and his counsel (if the Officer chooses to have counsel present) shall have a reasonable opportunity to be heard by the Directors at the meeting. Nothing in this Agreement limits the Officer's or his beneficiaries' right to contest the validity or propriety of the determination of Cause by the Directors. Upon termination for Cause, the Executive shall not be entitled to any further compensation or other benefits beyond his effective termination date, except any benefits to which he may be entitled under the Bank's benefit plans and policies in effect on the date of termination or such benefits which by the terms of the plan document continue after such termination. For purposes of this Employment Agreement, "Cause" means any of the following:

(i) an intentional act of fraud, embezzlement, or theft by the Officer in the course of

his employment. For purposes of this Agreement, no act or failure to act on the part of the Officer shall be deemed to have been intentional if it was due primarily to an error in judgment or negligence. An act or failure to act on the Officer's part shall be considered intentional if it was not in good faith and if it was without a reasonable belief that the action or failure to act was in the best interests of the Bank; or

(ii) intentional misconduct of the Officer, which in the reasonable judgment of the Directors has a material adverse effect on, or causes material harm to, the Bank, including, without limitation, the reputation of the Bank; or

(iii) the Officer's willful and repeated refusal to perform material duties or gross negligence in the performance of his duties to the Bank; or

(iv) a breach by the Officer of his fiduciary duties as an officer or director of the Bank or Gateway Financial Holdings, Inc., in either case, whether in his capacity as an officer or as a director of the Bank or Gateway Financial Holdings, Inc.; or

(v) a breach by the Officer of this Agreement that, in the reasonable judgment of the Directors, is a material breach, which breach is not corrected by the Officer within 30 days after receiving written notice of the breach from the Directors; or

(vi) removal of the Officer from office or permanent prohibition of the Officer from participating in the Bank's affairs by an order issued under section 8(e) (4) or (g) (1) of the Federal Deposit Insurance Act, 12 U.S.C. 1818(e) (4) or (g)(1); or

(vii) conviction of the Officer for or plea of *nob contendere* to a felony or the actual incarceration of the Officer.

Notwithstanding such termination, the obligations under Paragraph 6(c) shall survive any termination of employment.

(d) Subject to the Bank's obligations and the Officer's rights under (i) Title I of the Americans with Disabilities Act, §504 of the Rehabilitation Act, and the Family and Medical Leave Act, and to (ii) the vacation leave, disability leave, sick leave and any other leave policies of the Bank, the Officer's employment under this Agreement automatically shall be terminated in the event the Officer becomes disabled during the term of this Agreement and it is determined by the Bank that the Officer is unable to perform the essential functions of the Officer's job under this Agreement for ninety (90) business days or more during any 12-month period. Upon any such termination, the Officer shall be entitled to receive any compensation the Officer shall have earned prior to the date of termination but which remains unpaid, and shall be entitled to any payments provided under any disability income plan of the Bank which is applicable to the Officer.

In the event of any disagreement between the Officer and the Bank as to whether the Officer is physically or mentally incapacitated such as will result in the termination of the Officer's employment pursuant to this Paragraph 8(d), the question of such incapacity shall be submitted to an impartial physician licensed to practice medicine in North Carolina for determination and who will be selected by mutual agreement of the Officer and the Bank, or failing such agreement, by two (2) physicians (one (1) of whom shall be selected by the Bank and the other by the Officer), and such determination of the question of such incapacity by such physician or physicians shall be final and binding on the Officer and the Bank. The Bank shall pay the reasonable fees and expenses of such physician or physicians in making any determination required under this Paragraph 8(d).

9. **Additional Regulatory Requirements.** Notwithstanding anything contained in this Agreement to the contrary, it is understood and agreed that the Bank (or any of its successors in interest) shall not be required to make any payment or take any action under this Agreement if:

(a) such payment or action is prohibited by any governmental agency having jurisdiction over the Bank (hereinafter referred to as "Regulatory Authority") because the Bank is declared by such Regulatory Authority to be insolvent, in default or operating in an unsafe or unsound manner; or,

(b) in the reasonable opinion of counsel to the Bank, such payment or action (i) would be prohibited by or would violate any provision of state or federal law applicable to the Bank, including, without limitation, the Federal Deposit Insurance Act as now in effect or hereafter amended, (ii) would be prohibited by or would violate any applicable rules, regulations, orders or statements of policy, whether now existing or hereafter promulgated, of any Regulatory Authority, or (iii) otherwise would be prohibited by any Regulatory Authority.

10. **Change in Control.** (a) In the event of a termination of the Officer’s employment in connection with, or within twenty-four (24) months after, a "Change in Control" (as defined in Subparagraph (d) below) other than for Cause (as defined in Paragraph 8), the Officer shall be entitled to receive the amount set forth in Subparagraph (c) below. Said sum shall be payable as provided in Subparagraph (e) below.

(b) In addition to any rights the Officer might have to terminate this Agreement contained in Paragraph 8, the Officer shall have the right to terminate this Agreement upon the occurrence of any of the following events (the "Termination Events") within twenty-four months following a Change in Control:

(i) Officer is assigned any duties and/or responsibilities that, in Officer’s reasonable determination, are inconsistent with or constitute a demotion or reduction in the Officer’s position, duties, responsibilities or status as such existed at the time of the Change in Control or with his reporting responsibilities or titles with the Bank in effect at such time, regardless of Officer’s resulting position; or

(ii) Officer’s annual base salary rate is reduced below the annual amount in effect as of the effective date of a Change in Control or as the same shall have been increased from time to time following such effective date; or

(iii) Officer’s life insurance, medical or hospitalization insurance, disability insurance, stock options plans, stock purchase plans, deferred compensation plans, management retention plans, retirement plans or similar plans or benefits being provided by the Bank to the Officer as of the effective date of the Change in Control are reduced in their level, scope or coverage, or any such insurance, plans or benefits are eliminated, unless such reduction or elimination applies proportionately to all salaried employees of the Bank who participated in such benefits prior to such Change in Control; or

(iv) Officer is transferred to a location which is more than 15 miles from his current principal work location without the Officer’s express written consent.

A Termination Event shall be deemed to have occurred on the date such action or event is implemented or takes effect.

(c) In the event that the Officer’s employment is terminated pursuant to this Paragraph 10, the Bank will be obligated to pay or cause to be paid to Officer an amount equal to 2.99 times the Officer’s "base amount" as defined in Section 280G(b)(3) of the Internal Revenue Code of 1986, as amended (the "Code").

(d) For the purposes of this Agreement, the term Change in Control shall mean any of the following events:

(i) Any person, or more than one person acting as a group, accumulates ownership of the common stock of Gateway Financial Holdings, Inc. ("Gateway Financial") constituting more than 50% of the total fair market value or total voting power of Gateway Financial’s common stock,

(ii) Any person, or more than one person acting as a group, acquires within a 12-month

period ownership of Gateway Financial's common stock possessing 30% or more of the total voting power of Gateway Financial's common stock;

(iii) A majority of Gateway Financial's Board of Directors is replaced during any 12-month period by directors whose appointment or election is not endorsed in advance by a majority of Gateway Financial's Board of Directors before the date of appointment or election, or

(iv) Within a 12-month period, any person, or more than one person acting as a group, acquires assets from Gateway Financial having a total gross fair market value equal to or exceeding 40% of the total gross fair market value of all of the assets of Gateway Financial immediately before the acquisition or acquisitions. For this purpose, "gross fair market value" means the value of Gateway Financial's assets, or the value of the assets being disposed of, determined without regard to any liabilities associated with the assets

Persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase, or acquisition of stock, or a similar transaction, involving Gateway Financial. Notwithstanding the other provisions of this Paragraph 10, a transaction or event shall not be considered a Change in Control if, prior to the consummation or occurrence of such transaction or event, the Officer and Bank agree in writing that the same shall not be treated as a Change in Control for purposes of this Agreement.

(e) Such amounts payable pursuant to this Paragraph 10 shall be paid, at the option of the Officer, either in one lump sum or in thirty-six (36) equal monthly payments following termination of Officer's employment.

(f) Following a Termination Event which gives rise to Officer's rights hereunder, the Officer shall have twelve (12) months from the date of occurrence of the Termination Event to terminate this Agreement pursuant to this Paragraph 10. Any such termination shall be deemed to have occurred only upon delivery to the Bank (or to any successor corporation) of written notice of termination which describes the Change in Control and the Termination Event. If Officer does not so terminate this Agreement within such twelve-month period, he shall thereafter have no further rights hereunder with respect to that Termination Event, but shall retain rights, if any, hereunder with respect to any other Termination Event as to which such period has not expired.

(g) If the Officer receives the payment pursuant to this Paragraph 10 and acceleration of benefits under any other benefit, compensation, or incentive plan or arrangement with the Bank or its parent corporation (collectively, the "Total Benefits"), and if any part of the Total Benefits is subject to an excise tax under Section 280G and Section 4999 of the Code (the "Excise Tax"), the Bank shall pay to the Officer the following additional amounts, consisting of (*x*) a payment equal to the Excise Tax payable by the Officer under section 4999 on the Total Benefits (the "Excise Tax Payment") and (*y*) a payment equal to the amount necessary to provide the Excise Tax Payment net of all income, payroll, and excise taxes. Together, the additional amounts described in clauses (*x*) and (*y*) are referred to in this Agreement as the "Gross-Up Payment Amount." Payment of the Gross-Up Payment Amount shall be made in addition to the amount set forth in Subparagraph 10(c) above.

For purposes of determining whether any of the Total Benefits will be subject to the Excise Tax and for purposes of determining the amount of the Excise Tax, any other payments or benefits received or to be received by the Officer in connection with a Change in Control or the Officer's termination of employment following a Change in Control (whether under the terms of this Agreement or any other agreement or any other benefit plan or arrangement with the Bank or its parent corporation) shall be treated as "parachute payments" within the meaning of section 280G(b)(2) of the Code, and all "excess parachute payments" within the meaning of section 280G(b)(1) shall be treated as subject to the Excise Tax, unless in the opinion of the certified public accounting firm that is retained by the Bank as of the date immediately before the Change in Control (the "Accounting Firm"), such other payments or benefits do not constitute (in whole or in part) parachute payments, or such excess parachute payments represent

(in whole or in part) reasonable compensation for services actually rendered within the meaning of section 280G(b)(4) of the Code in excess of the "base amount" (as defined in section 280G(b)(3) of the Code), or are otherwise not subject to the Excise Tax. The value of any noncash benefits or any deferred payment or benefit shall be determined by the Accounting Firm in accordance with the principles of sections 280G(d)(3) and (4) of the Code.

For purposes of determining the Gross-Up Payment Amount, the Officer shall be deemed to pay federal income taxes at the highest marginal rate of federal income taxation in the calendar years in which the Gross-Up Payment Amount is to be made and state and local income taxes at the highest marginal rate of taxation in the state and locality of the Officer’s residence on the date of termination of employment, net of the reduction in federal income taxes that can be obtained from deduction of such state and local taxes (calculated by assuming that any reduction under section 68 of the Code in the amount of itemized deductions allowable to the Officer applies first to reduce the amount of such state and local income taxes that would otherwise be deductible by the Officer, and applicable federal FICA and Medicare withholding taxes).

All determinations required to be made under this Subparagraph, including whether and when a Gross-Up Payment Amount is required, the amount of the Gross-Up Payment Amount and the assumptions to be used to arrive at the determination (collectively, the "Determination"), shall be made by the Accounting Firm, which shall provide detailed supporting calculations both to the Bank and the Officer within 15 business days after receipt of notice from the Bank or the Officer that there has been a Gross-Up Payment Amount, or such earlier time as is requested by the Bank. All fees and expenses of the Accounting Firm shall be borne solely by the Bank. The Bank shall enter into any reasonable agreement requested by the Accounting Firm in connection with the performance of its services hereunder. If the Accounting Firm determines that no Excise Tax is payable by the Officer, the Accounting Firm shall furnish the Officer with a written opinion to that effect, and to the effect that failure to report an Excise Tax, if any, on the Officer’s applicable federal income tax return will not result in the imposition of a negligence or similar penalty.

The Determination by the Accounting Firm shall be binding on the Bank and the Officer. If, after a Determination by the Accounting Firm, the Officer is required to make a payment of additional Excise Tax ("Underpayment"), the Accounting Firm shall determine the amount of the Underpayment that has occurred. The Underpayment (together with interest at the rate provided in section 1274(d)(2)(B) of the Code) shall be paid promptly by the Bank to or for the benefit of the Officer. If the Gross-Up Payment Amount exceeds the amount necessary to reimburse the Officer for his Excise Tax ("Overpayment"), the Accounting Firm shall determine the amount of the Overpayment that has been made. The Overpayment (together with interest at the rate provided in section 1274(d)(2)(B) of the Code) shall be paid promptly by the Officer to or for the benefit of the Bank. Provided that his expenses are reimbursed by the Bank, the Officer shall cooperate with any reasonable requests by the Bank in any contests or disputes with the Internal Revenue Service relating to the Excise Tax.

If the Accounting Firm is serving as accountant or auditor for the individual, entity, or group effecting the Change in Control, the Officer, in his sole discretion, may appoint another nationally recognized public accounting firm to make the Determinations required hereunder (in which case the term "Accounting Firm" as used in this Employment Agreement shall be deemed to refer to the accounting firm appointed by the Officer under this Subparagraph).

(h) In the event any dispute shall arise between the Officer and the Bank as to the terms or interpretation of this Agreement, including this Paragraph 10, whether instituted by formal legal proceedings or otherwise, including any action taken by the Officer to enforce the terms of this Paragraph 10 or in defending against any action taken by the Bank, the Bank shall reimburse the Officer for all costs and expenses, proceedings or actions, in the event the Officer prevails in any such action.

11. **Successors and Assigns.** (a) This Agreement shall inure to the benefit of and be binding upon any corporate or other successor of the Bank which shall acquire, directly or indirectly, by conversion, merger, purchase or otherwise, all or substantially all of the assets of the Bank.

(b) Since the Bank is contracting for the unique and personal skills of the Officer, the Officer shall be precluded from assigning or delegating his rights or duties hereunder without first obtaining the written consent of the Bank.

12. **Modification; Wavier; Amendments**. This Agreement represents, constitutes, and incorporates the entire, exclusive, and complete understanding of the parties hereto and replaces all previous agreements. No provision of this Agreement may be modified, waived or discharged unless such waiver, modification or discharge is agreed to in writing, signed by the Officer and on behalf of the Bank by such officer as may be specifically designated by the Board of Directors. No waiver by either party hereto, at any time, of any breach by the other party hereto of, or compliance with, any condition or provision of this Agreement to be performed by such other party shall be deemed a waiver of similar or dissimilar provisions or conditions at the same or at any prior or subsequent time. No amendment or addition to this Agreement shall be binding unless in writing and signed by both parties, except as herein otherwise provided.

13. **Applicable Law**. This Agreement shall be governed in all respects whether as to validity, construction, capacity, performance or otherwise, by the laws of North Carolina, except to the extent that federal law shall be deemed to apply.

14. **Severability**. The provisions of this Agreement shall be deemed severable and the invalidity or unenforceability of any provision shall not affect the validity or enforceability of the other provisions hereof.

15. **Previous Agreement**. This Agreement replaces the previous employment agreements between the Officer and the Bank, which established the non-competition covenant in consideration of Officer’s employment by the Bank. The Officer acknowledges that the grant of health insurance in Paragraph 4(d) and the substitution of this Agreement for the previous agreements constitute sufficient and adequate consideration for the covenants in Paragraph 6 of this Agreement. The Officer further acknowledges, by execution of this Amended Agreement, that the amendments to this Agreement have no effect on, and the Officer reaffirms and ratifies, the covenants in Paragraph 6 of this Agreement.

IN WITNESS WHEREOF, the parties have executed this amended Agreement as of the day and year first hereinabove written.

GATEWAY BANK & TRUST CO.

By: /s/ D. Ben Berry
D. Ben Berry, Chief Executive Officer

Attest:

/s/ Wendy W. Small
Corporate Secretary

OFFICER

/s/ David R. Twiddy **[SEAL]**
David R. Twiddy

Section 7: EX-10.7 (EXHIBIT 10.7)

Exhibit 10.7

EMPLOYMENT AGREEMENT

THIS AGREEMENT is amended as of December 1, 2007 by and between **GATEWAY BANK & TRUST CO.,** a North Carolina banking corporation (hereinafter referred to as the "Bank") and **THEODORE L. SALTER**, an individual resident of Virginia (hereinafter referred to as the "Officer").

For and in consideration of their mutual promises, covenants and conditions hereinafter set forth, and other good and valuable consideration, the receipt and sufficiency of which hereby is acknowledged, the parties agree as follows:

1. **Employment**. The Bank agrees to employ the Officer and the Officer agrees to accept employment upon the terms and conditions stated herein as the Chief Financial Officer of the Bank. The Officer shall render such administrative and management services to the Bank as are customarily performed by persons situated in a similar executive capacity. The Officer shall promote the business of the Bank and perform such other duties as shall, from time to time, be reasonably assigned by the Chief Executive Officer of the Bank. Upon the request of the Chief Executive Officer, the Officer shall disclose all business activities or commercial pursuits in which Officer is engaged, other than Bank duties.

2. **Compensation**. The Bank shall pay the Officer during the term of this Agreement, as compensation for all services rendered by the Officer to the Bank, a base salary at the rate of $215,000 per annum, payable in cash not less frequently than monthly. The rate of such salary shall be reviewed by the Compensation Committee of the Board of Directors of the Bank (the "Committee") not less often than annually and the Committee may increase, but shall not decrease, such rate during the term of this Agreement. Such rate of salary, or increased rate of salary, as the case may be, may be further increased from time to time in such amounts as the Committee, in its discretion, may decide. In determining salary increases, the Committee shall compensate the Officer for increases in the cost of living and may also provide for performance or merit increases. Participation in the Bank’s incentive compensation, deferred compensation, discretionary bonus, profit-sharing, retirement and other employee benefit plans and participation in any fringe benefits shall not reduce the salary payable to the Officer under this Paragraph. In the event of a Change in Control (as defined in Paragraph 10), the Officer’s rate of salary shall be increased not less than five percent annually during the term of this Agreement. Any payments made under this Agreement shall be subject to such deductions as are required by law or regulation or as may be agreed to by the Bank and the Officer.

3. **Discretionary Bonuses**. During the term of this Agreement, the Officer shall be entitled to such discretionary bonuses as may be authorized, declared and paid by the Committee to the Bank’s key management employees. No other compensation provided for in this Agreement shall be deemed a substitute for the Officer’s right to such discretionary bonuses when and as declared by the Committee.

4. **Participation in Retirement and Employee Benefit Plans; Fringe Benefits.**

(a) The Bank shall provide family medical coverage and disability insurance for the Officer and the Officer shall also be entitled to participate in any plan relating to deferred compensation, stock options, stock purchases, pension, thrift, profit sharing, group life insurance, education, or other retirement or employee benefits that the Bank has adopted, or may, from time to time adopt, for the benefit of its executive employees or for employees generally, subject to the eligibility rules of such plans.

(b) The Officer shall also be entitled to participate in any other fringe benefits which are now or may be or become applicable to the Bank’s executive employees, including the payment of reasonable

expenses for attending annual and periodic meetings of trade associations, and any other benefits which are commensurate with the duties and responsibilities to be performed by the Officer under this Agreement. Additionally, the Officer shall be entitled to such vacation and sick leave as shall be established under uniform employee policies promulgated by the Bank. The Bank shall reimburse the Officer for all out-of-pocket reasonable and necessary business expenses which the Officer may incur in connection with the Officer's services on behalf of the Bank.

(c) The Bank shall pay the dues of the Officer for membership in the Kingsmill Country Club and one additional country club in the market area of the Bank at the Officer's election and dues for membership in civic clubs. The Bank shall also provide the Officer with the use of a late model automobile suitable to the status of the Officer of a type and for lease terms to be approved by the Committee and with the use of a cellphone.

5. **Term**. The initial term of employment under this Agreement shall be for the period commencing upon April 17, 2006 and ending three calendar years from that date. On each anniversary of the effective date of this Agreement, the term of this Agreement shall automatically be extended for an additional one-year period beyond the then effective expiration date unless written notice from the Bank or the Officer is received 90 days prior to an anniversary date advising the other that this Agreement shall not be further extended; provided that the Committee shall review the Officer's performance annually and make a specific determination pursuant to such review to renew this Agreement prior to the 90 days' notice.

6. **Loyalty; Noncompetition; Confidentiality.**

(a) The Officer shall devote his full efforts and entire business time to the performance of the Officer's duties and responsibilities under this Agreement.

(b) During the term of this Agreement, or any renewals thereof, and for a period of one year after termination, the Officer agrees he will not, within the "Restricted Area," directly or indirectly, engage in any business that competes with the Bank or any of its subsidiaries without the prior written consent of the Bank; provided, however, that the provisions of this Paragraph shall not apply in the event the Officer's employment is unilaterally terminated by the Bank for Cause, (as such term is defined in Paragraph 8(c) hereof) or in the event the Officer terminates his employment with the Bank after the occurrence of a "Termination Event" (as such term is defined in Paragraph 10(b) hereof) following a "Change of Control" (as such term is defined in Paragraph 10(d) hereof). The Restricted Area covers the following divisible list of territories: Camden, Chowan, Currituck, Dare, Pasquotank, and Perquimans Counties, North Carolina and Chesapeake and Virginia Beach, Virginia, and within 15 miles of any Bank office operated during the term of this Agreement. The one-year restricted period, however, does not include any period of violation or period of time required for litigation to enforce the Officer's agreement not to compete against the Bank. Notwithstanding the foregoing, the Officer shall be free, without such consent, to purchase or hold as an investment or otherwise, up to five percent of the outstanding stock or other security of any corporation which has its securities publicly traded on any recognized securities exchange or in any over-the counter market.

(c) The Officer agrees he will hold in confidence all knowledge or information of a confidential nature with respect to the business of the Bank or any subsidiary received by the Officer during the term of this Agreement and will not disclose or make use of such information without the prior written consent of the Bank. The Officer agrees that he will be liable to the Bank for any damages caused by unauthorized disclosure of such information. Upon termination of his employment, the Officer agrees to return all records or copies thereof of the Bank or any subsidiary in his possession or under his control which relate to the activities of the Bank or any subsidiary.

(d) The Officer acknowledges that it would not be possible to ascertain the amount of monetary damages in the event of a breach by the Officer under the provisions of this Paragraph 6. The Officer agrees that, in the event of a breach of this Paragraph 6, injunctive relief enforcing the terms of this Paragraph 6 is an appropriate remedy. If the scope of any restriction contained in this Paragraph 6 is determined to be too broad by any court of competent jurisdiction, then such restriction shall be enforced to the maximum extent permitted by law and the Officer consents that the scope of this restriction may be modified judicially.

7. **Standards**. The Officer shall perform his duties and responsibilities under this Agreement in accordance with such reasonable standards expected of employees with comparable positions in comparable organizations and as may be established from time to time by the Bank. The Bank will provide the Officer with the working facilities and staff customary for similar executives and necessary for the Officer to perform his duties.

8. **Termination and Termination Pay.** (a) The Officer's employment under this Agreement shall be terminated upon the death of the Officer during the term of this Agreement, in which event, the Officer's estate shall be entitled to receive the compensation due the Officer through the last day of the calendar month in which the Officer's death shall have occurred and for a period of one month thereafter.

(b) The Officer's employment under this Agreement may be terminated at any time by the Officer upon 60 days' written notice to the Bank. Upon such termination, the Officer shall be entitled to receive compensation through the effective date of such termination.

(c) The Bank may terminate the Officer's employment at any time, but any termination by the Bank, other than termination for Cause, shall not prejudice the Officer's right to compensation or other benefits under this Agreement. The Bank shall provide written notice specifying the grounds for termination for Cause. The Officer shall have no right to receive compensation or other benefits for any period after termination for Cause. Termination for Cause shall include termination because of the Officer's personal dishonesty or moral turpitude, willful misconduct, breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule, or regulation (other than traffic violations or similar offenses) or final cease-and-desist order, or material breach of any provision of this Agreement. Notwithstanding such termination, the obligations under Paragraph 6(c) shall survive any termination of employment.

(d) Subject to the Bank's obligations and the Officer's rights under (i) Title I of the Americans with Disabilities Act, §504 of the Rehabilitation Act, and the Family and Medical Leave Act, and to (ii) the vacation leave, disability leave, sick leave and any other leave policies of the Bank, the Officer's employment under this Agreement automatically shall be terminated in the event the Officer becomes disabled during the term of this Agreement and it is determined by the Bank that the Officer is unable to perform the essential functions of the Officer's job under this Agreement for ninety (90) business days or more during any 12-month period. Upon any such termination, the Officer shall be entitled to receive any compensation the Officer shall have earned prior to the date of termination but which remains unpaid, and shall be entitled to any payments provided under any disability income plan of the Bank which is applicable to the Officer.

In the event of any disagreement between the Officer and the Bank as to whether the Officer is physically or mentally incapacitated such as will result in the termination of the Officer's employment pursuant to this Paragraph 8(d), the question of such incapacity shall be submitted to an impartial physician licensed to practice medicine in North Carolina for determination and who will be selected by mutual agreement of the Officer and the Bank, or failing such agreement, by two (2) physicians (one (1) of whom shall be selected by the Bank and the other by the Officer), and such determination of the question of such incapacity by such physician or physicians shall be final and binding on the Officer and

the Bank. The Bank shall pay the reasonable fees and expenses of such physician or physicians in making any determination required under this Paragraph 8(d).

9. **Additional Regulatory Requirements.** Notwithstanding anything contained in this Agreement to the contrary, it is understood and agreed that the Bank (or any of its successors in interest) shall not be required to make any payment or take any action under this Agreement if:

(a) such payment or action is prohibited by any governmental agency having jurisdiction over the Bank (hereinafter referred to as "Regulatory Authority") because the Bank is declared by such Regulatory Authority to be insolvent, in default or operating in an unsafe or unsound manner; or,

(b) in the reasonable opinion of counsel to the Bank, such payment or action (i) would be prohibited by or would violate any provision of state or federal law applicable to the Bank, including, without limitation, the Federal Deposit Insurance Act as now in effect or hereafter amended, (ii) would be prohibited by or would violate any applicable rules, regulations, orders or statements of policy, whether now existing or hereafter promulgated, of any Regulatory Authority, or (iii) otherwise would be prohibited by any Regulatory Authority.

10. **Change in Control.** (a) In the event of a termination of the Officer's employment in connection with, or within twenty-four (24) months after, a "Change in Control" (as defined in Subparagraph (d) below) of the Bank other than for Cause (as defined in Paragraph 8), the Officer shall be entitled to receive the amount set forth in Subparagraph (c) below. Said sum shall be payable as provided in Subparagraph (e) below.

(b) In addition to any rights the Officer might have to terminate this Agreement contained in Paragraph 8, the Officer shall have the right to terminate this Agreement upon the occurrence of any of the following events (the "Termination Events") within twenty-four months following a Change in Control of the Bank:

(i) Officer is assigned any duties and/or responsibilities that, in Officer's reasonable determination, are inconsistent with or constitute a demotion or reduction in the Officer's position, duties, responsibilities or status as such existed at the time of the Change in Control or with his reporting responsibilities or titles with the Bank in effect at such time, regardless of Officer's resulting position; or

(ii) Officer's annual base salary rate is reduced below the annual amount in effect as of the effective date of a Change in Control or as the same shall have been increased from time to time following such effective date; or

(iii) Officer's life insurance, medical or hospitalization insurance, disability insurance, stock options plans, stock purchase plans, deferred compensation plans, management retention plans, retirement plans or similar plans or benefits being provided by the Bank to the Officer as of the effective date of the Change in Control are reduced in their level, scope or coverage, or any such insurance, plans or benefits are eliminated, unless such reduction or elimination applies proportionately to all salaried employees of the Bank who participated in such benefits prior to such Change in Control; or

(iv) Officer is transferred to a location which is more than 15 miles from his current principal work location without the Officer's express written consent.

A Termination Event shall be deemed to have occurred on the date such action or event is implemented or takes effect.

(c) In the event that the Officer's employment is terminated pursuant to this Paragraph 10, the Bank will be obligated to pay or cause to be paid to Officer an amount equal to 2.99 times the Officer's "base amount" as defined in Section 280G(b)(3) of the Internal Revenue Code of 1986, as amended (the "Code").

(d) For the purpose of this Agreement, the term "Change in Control" shall mean:

(i) Any person, or more than one person acting as a group, accumulates ownership of the common stock of Gateway Financial Holdings, Inc. ("Gateway Financial") constituting more than 50% of the total fair market value or total voting power of Gateway Financial's common stock,

(ii) Any person, or more than one person acting as a group, acquires within a 12-month period ownership of Gateway Financial's common stock possessing 30% or more of the total voting power of Gateway Financial's common stock;

(iii) A majority of Gateway Financial's Board of Directors is replaced during any 12-month period by directors whose appointment or election is not endorsed in advance by a majority of Gateway Financial's Board of Directors before the date of appointment or election, or

(iv) Within a 12-month period, any person, or more than one person acting as a group, acquires assets from Gateway Financial having a total gross fair market value equal to or exceeding 40% of the total gross fair market value of all of the assets of Gateway Financial immediately before the acquisition or acquisitions. For this purpose, "gross fair market value" means the value of Gateway Financial's assets, or the value of the assets being disposed of, determined without regard to any liabilities associated with the assets

Persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase, or acquisition of stock, or a similar transaction, involving Gateway Financial. Notwithstanding the other provisions of this Paragraph 10, a transaction or event shall not be considered a Change in Control if, prior to the consummation or occurrence of such transaction or event, the Employee and Bank agree in writing that the same shall not be treated as a Change in Control for purposes of this Agreement.

(e) Such amounts payable pursuant to this Paragraph 10 shall be paid, at the option of the Officer, either in one lump sum or in thirty-six (36) equal monthly payments following termination of Officer's employment.

(f) Following a Termination Event which gives rise to Officer's rights hereunder, the Officer shall have twelve (12) months from the date of occurrence of the Termination Event to terminate this Agreement pursuant to this Paragraph 10. Any such termination shall be deemed to have occurred only upon delivery to the Bank (or to any successor corporation) of written notice of termination which describes the Change in Control and the Termination Event. If Officer does not so terminate this Agreement within such twelve-month period, he shall thereafter have no further rights hereunder with respect to that Termination Event, but shall retain rights, if any, hereunder with respect to any other Termination Event as to which such period has not expired.

(g) In the event any dispute shall arise between the Officer and the Bank as to the terms or interpretation of this Agreement, including this Paragraph 10, whether instituted by formal legal proceedings or otherwise, including any action taken by the Officer to enforce the terms of this Paragraph 10 or in defending against any action taken by the Bank, the Bank shall reimburse the Officer for all costs and expenses, proceedings or actions, in the event the Officer prevails in any such action.

11. **<u>Successors and Assigns.</u>** (a) This Agreement shall inure to the benefit of and be binding upon any corporate or other successor of the Bank which shall acquire, directly or indirectly, by conversion, merger, purchase or otherwise, all or substantially all of the assets of the Bank.

(b) Since the Bank is contracting for the unique and personal skills of the Officer, the Officer shall be precluded from assigning or delegating his rights or duties hereunder without first obtaining the written consent of the Bank.

12. **<u>Modification; Wavier; Amendments</u>**. This Agreement represents, constitutes, and incorporates the entire, exclusive, and complete understanding of the parties hereto and replaces all previous

agreements. This Agreement replaces the "probationary period" employment letter between the Officer and the Bank dated as of his employment, which established the non-competition covenant in consideration of Officer's employment by the Bank. The Officer, by execution of this Agreement, acknowledges that by acceptance of the terms of this Agreement, the Officer agrees not to dispute, and waives any argument as to, the adequacy of the consideration for the non-competition and other covenants in this Agreement. No provision of this Agreement may be modified, waived or discharged unless such waiver, modification or discharge is agreed to in writing, signed by the Officer and on behalf of the Bank by such officer as may be specifically designated by the Board of Directors. No waiver by either party hereto, at any time, of any breach by the other party hereto of, or compliance with, any condition or provision of this Agreement to be performed by such other party shall be deemed a waiver of similar or dissimilar provisions or conditions at the same or at any prior or subsequent time. No amendment or addition to this Agreement shall be binding unless in writing and signed by both parties, except as herein otherwise provided.

13. **Applicable Law**. This Agreement shall be governed in all respects whether as to validity, construction, capacity, performance or otherwise, by the laws of North Carolina, except to the extent that federal law shall be deemed to apply.

14. **Severability**. The provisions of this Agreement shall be deemed severable and the invalidity or unenforceability of any provision shall not affect the validity or enforceability of the other provisions hereof.

IN WITNESS WHEREOF, the parties have amended this Agreement as of the day and year first hereinabove written.

GATEWAY BANK & TRUST CO.

By: /s/ D. Ben Berry
D. Ben Berry, Chief Executive Officer

Attest:

/s/ Wendy W. Small
Corporate Secretary

OFFICER

/s/ Theodore L. Salter [SEAL]
Theodore L. Salter

Section 8: EX-10.8 (EXHIBIT 10.8)

Exhibit 10.8

SALARY CONTINUATION AGREEMENT

THIS SALARY CONTINUATION AGREEMENT (this "Agreement") is entered into as of this first day of October 1, 2006, by and between **GATEWAY BANK & TRUST CO.,** a North Carolina banking corporation (hereinafter referred to as the "Bank" or "Employer"), and **D. BEN BERRY**, an individual resident of Virginia (hereinafter referred to as the "Executive").

WHEREAS, the Executive has contributed substantially to the success of the Employer and the Employer desires that the Executive continue in its employ;

WHEREAS, to encourage the Executive to remain an employee of the Employer, the Employer is willing to provide salary continuation benefits to the Executive, payable out of the Employer's general assets; and

WHEREAS, the parties hereto intend that this Agreement shall be considered an unfunded arrangement maintained primarily to provide supplemental retirement benefits for the Executive, and shall be considered a plan described in Section 301(a)(3) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA").

NOW THEREFORE, in consideration of the foregoing premises and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows.

ARTICLE 1
DEFINITIONS

Whenever used in this Agreement, the following terms have the meanings specified —

1.1 *"Accrual Balance"* means the liability that should be accrued by the Employer under accounting principles generally accepted in the United States ("GAAP") for the Employer's obligation to the Executive under this Agreement, by applying Accounting Principles Board Opinion No. 12, as amended by Statement of Financial Accounting Standards No. 106, and the calculation method and discount rate specified hereinafter. The Accrual Balance shall be determined by the liability accrued by the bank as of the Effective Date. The projected Accrual Balance is detailed on Schedule A including annual accruals. The Accrual Balance shall be calculated assuming a level principal amount and interest as the discount rate is accrued each period. The principal accrual is determined such that when it is credited with interest each month, the Accrual Balance at Normal Retirement Age equals the present value of the normal retirement benefits described in Section 2.1.1(a) and (b). At the end of each Plan Year, the Accrual Balance shall be adjusted to reflect the Employer's obligation under Sections 2.1.1(a) in terms of the Executive's actual base salary for that Plan Year. The discount rate means the rate used by the Plan Administrator for determining the Accrual Balance. The rate is based on the yield on a 20-year corporate bond rated Aa by Moody's, rounded to the nearest 1/4%, or as otherwise determined by the governing Regulatory body. The initial discount rate is 5.75%. In its sole discretion, the Plan Administrator may adjust the discount rate to maintain the rate within reasonable standards according to GAAP and consistent with the Interagency Advisory on Accounting for Deferred Compensation Agreements which states that the "cost of those benefits shall be accrued over that period of the employee's service in a systematic and rational manner."

1.2 *"Beneficiary"* means each designated person, or the estate of the deceased Executive, entitled to benefits, if any, upon the death of the Executive, determined according to Article 4.

1.3 *"Beneficiary Designation Form"* means the form established from time to time by the Plan Administrator that the Executive completes, signs, and returns to the Plan Administrator to designate one or more Beneficiaries.

1.4 *"Change in Control"* For the purposes of this Agreement, the term Change in Control shall mean a change in control as defined in Section 409A of the Code, including any of the following events:

(i) Any person, or more than one person acting as a group, accumulates ownership of the common stock of Gateway Financial Holdings, Inc. ("Gateway Financial") constituting more than 50% of the total fair market value or total voting power of Gateway Financial's common stock,

(ii) Any person, or more than one person acting as a group, acquires within a 12-month period ownership of Gateway Financial's common stock possessing 30% or more of the total voting power of Gateway Financial's common stock;

(iii) A majority of Gateway Financial's Board of Directors is replaced during any 12-month period by directors whose appointment or election is not endorsed in advance by a majority of Gateway Financial's Board of Directors before the date of appointment or election, or

(iv) Within a 12-month period, any person, or more than one person acting as a group, acquires assets from Gateway Financial having a total gross fair market value equal to or exceeding 40% of the total gross fair market value of all of the assets of Gateway Financial immediately before the acquisition or acquisitions. For this purpose, "gross fair market value" means the value of Gateway Financial's assets, or the value of the assets being disposed of, determined without regard to any liabilities associated with the assets

Persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase, or acquisition of stock, or a similar transaction, involving Gateway Financial. Notwithstanding the other provisions of this Section 1.4, a transaction or event shall not be considered a Change in Control if, prior to the consummation or occurrence of such transaction or event, Executive and Bank agree in writing that the same shall not be treated as a Change in Control for purposes of this Agreement.

1.4A *"Code"* means the Internal Revenue Code of 1986, as amended.

1.5 *"Disability"* means the Executive suffers a sickness, accident or injury that is determined by the carrier of any individual or group disability insurance policy covering the Executive to be a disability rendering the Executive totally and permanently disabled, as certified by a physician chosen by the Employer and reasonably acceptable to the Executive, or as later defined by the Internal Revenue Service in IRS Notice 2005 — 1.

1.6 *"Early Retirement Date"* means the date of the Executive's Termination of Employment with the Employer for reasons other than death, Disability, Termination for Cause, termination under Article *5* of this Agreement, or within twenty-four (24) months after a Change

in Control, provided, however, that an Early Retirement Date may only occur following the later of the date the Executive attains age sixty-two (62) or the date the Executive has been continuously employed by the Employer for ten (10) years.

1.7 *"Effective Date"* means October 1, 2006.

1.8 *"Final Average Salary"* means the Executive's average annual base salary for the three year period ending at Executive's Normal Retirement Date.

1.9 *"Good Reason"* shall mean any of the following events:

(i) Executive is assigned any duties and/or responsibilities that, in Executive's reasonable determination, are inconsistent with or constitute a demotion or reduction in the Executive's position, duties, responsibilities or status as such existed at the time of the Change in Control or with his reporting responsibilities or titles with the Bank in effect at such time, regardless of Executive's resulting position; or

(ii) Executive's annual base salary rate is reduced below the annual amount in effect as of the effective date of a Change in Control or as the same shall have been increased from time to time following such effective date; or

(iii) Executive's life insurance, medical or hospitalization insurance, disability insurance, stock options plans, stock purchase plans, deferred compensation plans, management retention plans, retirement plans or similar plans or benefits being provided by the Bank to the Executive as of the effective date of the Change in Control are reduced in their level, scope or coverage, or any such insurance, plans or benefits are eliminated, unless such reduction or elimination applies proportionately to all salaried employees of the Bank who participated in such benefits prior to such Change in Control; or

(iv) Executive is transferred to a location which is more than 15 miles from his current principal work location without the Executive's express written consent.

1.10 *"Normal Retirement Age"* means age sixty-five (65).

1.11 *"Normal Retirement Date"* means the date of the Executive's Termination of Employment on or after the Executive reaches Normal Retirement Age, other than a Termination of Employment due to the Executive's death or due to a Termination for Cause.

1.12 *"Person"* means an individual, corporation, partnership, trust, association, joint venture, pool, syndicate, sole proprietorship, unincorporated organization or other entity.

1.13 *"Plan Administrator"* means the plan administrator described in Article 8.

1.14 *"Plan Year"* means a twelve-month period commencing on January 1, and ending on December 31 of each year. The initial Plan Year shall commence on the Effective Date of this Agreement and end on December 31 of the year in which occurs the Effective Date.

1.15 *"Regulatory Body"* refers to The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS), also known as "the agencies".

1.16 *"Termination for Cause"* and *"Cause"* shall have the same definition specified in any effective severance or employment agreement existing on the date hereof or hereafter entered into between the Executive and the Bank. If the Executive is not a party to a severance or employment agreement containing a definition of termination for cause, Termination for Cause means the Bank terminates the Executive's employment because of:

(a) the Executive's gross negligence or gross neglect of duties or intentional and material failure to perform stated duties after written notice thereof, or

(b) disloyalty or dishonesty by the Executive in the performance of his duties, or a breach of the Executive's fiduciary duties for personal profit, in any case whether in his capacity as a director or officer, or

(c) intentional wrongful damage by the Executive to the business or property of the Bank or its affiliates, including without limitation the reputation of the Bank, which in the judgment of the Bank causes material harm to the Bank or affiliates, or

(d) a willful violation by the Executive of any applicable law or significant policy of the Bank or an affiliate that, in the Bank's judgment, results in an adverse effect on the Bank or the affiliate, regardless of whether the violation leads to criminal prosecution or conviction. For purposes of this Agreement, applicable laws include any statute, rule, regulatory order, statement of policy, or final cease-and-desist order of any governmental agency or body having regulatory authority over the Bank, or

(e) the occurrence of any event that results in the Executive being excluded from coverage, or having coverage limited for the Executive as compared to other executives of the Bank, under the Bank's blanket bond or other fidelity or insurance policy covering its directors, officers, or employees, or

(f) the Executive is removed from office or permanently prohibited from participating in the Bank's affairs by an order issued under section 8 (e) (4) or section 8(g) (1) of the Federal Deposit Insurance Act, 12 U.S.C. 1818(e) (4) or (g)(1), or

(g) conviction of the Executive for or plea of nolo contendere to a felony or conviction of or plea of nolo contendere to a misdemeanor involving moral turpitude, or the actual incarceration of the Executive for 45 consecutive days or more.

1.17 *"Termination of Employment"* with the Employer means that the Executive shall have ceased to be employed by the Employer for any reason whatsoever, excepting a leave of absence approved by the Employer. For purposes of this Agreement, if there is a dispute over the employment status of the Executive or the date of termination of the Executive's employment, the Employer shall have the sole and absolute right to decide the dispute.

ARTICLE 2
RETIREMENT BENEFITS

2.1 *Normal Retirement Benefit.* Upon the Executive's Termination of Employment on or after Normal Retirement Age for reason other than death, the Executive shall be eligible to receive the benefit described in this Section 2.1 in lieu of any other benefit under Article 2 of this Agreement provided no Change in Control benefit or Termination benefit has been paid as specified in Section 2.6.

2.1.1. *Amount of Benefit.* The amount of the annual benefit shall be equal to the following:

(a) *Fixed Benefit.* The annual benefit under this Section 2.1(a) is an amount equal to the benefit detailed on Schedule A payable annually for fifteen (15) years commencing upon the first month after attaining age 65.

(b) *Variable Benefit. Variable Benefit.* The variable benefit under this Section 2.1 (b) is an amount equal to seventy percent (70%) of the Executive's Final Average Salary, less the Fixed Benefit detailed on Schedule A, payable annually for fifteen (15) years commencing upon the first month after attaining age 65. If the benefit due under this Section 2.1 (b) is less than zero (0), then no benefit is payable under this Section 2.1 (b).

2.1.2. *Payment of Benefit.* The Employer shall pay the aggregate annual benefit described in Section 2.1.1 to the Executive over the remaining term in twelve (12) equal monthly installments payable on the first day of each month, beginning with the month after the Executive's Normal Retirement Date.

2.2 *Early Retirement Benefit.* Upon the Executive's Early Retirement Date, the Executive shall be eligible to receive the benefit described in this Section 2.2 in lieu of any other benefit under Article 2 of this Agreement.

2.2.1. *Amount of Benefit.* The annual benefit under this Section 2.2 is an amount equal to the Accrual Balance earned as of the last day of the Plan Year immediately preceding the Executive's Early Retirement Date.

2.2.2. *Payment of Benefit.* The Employer shall pay the early retirement benefit to the Executive over fifteen (15) years in twelve (12) equal monthly installments payable annually on the first day of each month, beginning with the month after the Executive reaches his Normal Retirement Age.

2.3 *Disability Benefit.* Upon the Executive's Termination of Employment due to a Disability before reaching Normal Retirement Age, the Executive shall be eligible to receive the benefit described in this Section 2.3 in lieu of any other benefit under this Agreement.

2.3.1. *Amount of Benefit.* The annual benefit under this Section 2.3 is an amount equal to the Accrual Balance earned as of the last day of the Plan Year

immediately preceding the effective date of the Executive's Termination of Employment.

2.3.2. *Payment of Benefit.* The Employer shall pay the Disability benefit to the Executive over fifteen (15) years in twelve (12) equal monthly installments payable on the first day of each month, beginning with the month after the Executive's Normal Retirement Age.

2.4 *Change in Control Benefit.* If, within twenty-four (24) months after a Change in Control, the Employer terminates the Executive's employment other than for Cause or as described in Section 5.2 hereof or if the Executive terminates employment for Good Reason, the Executive shall be eligible to receive the benefit described in this Section 2.4 instead of any other benefit under Article 2 of this Agreement.

2.41 *Amount of Benefit.* The annual benefit under this Section 2.4 is an amount equal to seventy percent (70%) of the Executive's final annual salary at the Executive's Termination of Employment, or the benefit detailed on Schedule A, whichever is greater, payable annually for fifteen (15) years commencing as of the last day of the Plan Month preceding the effective date of the Executive's Termination of Employment.

2.41.1 *Payment of Benefit.* The Employer shall pay the Change in Control benefit under Section 2.4 of this Agreement to the Executive over fifteen (15) years in twelve (12) equal monthly installments payable on the first day of each month, beginning with the month after the Executive's Termination of Employment.

2.41.2 *Change in Control Payout of Normal Retirement Benefit, Early Retirement Benefit, or Disability Benefit Being Paid to the Executive at the Time of a Change in Control.* If a Change in Control occurs at any time during the period in which the Executive is receiving payment of the benefit under Section 2.1, 2.2, or 2.3, the Employer shall pay the remaining benefits due to the Executive under the applicable section to the Executive in a single lump sum payment within thirty (30) days after the Change in Control.

2.5 *Termination Benefit.* Upon the Executive's Termination without Cause by the Employer, the Executive shall be eligible to receive the benefit described in this Section 2.5 in lieu of any other benefit under Article 2 of this Agreement.

2.5.1 *Amount of Benefit.* The annual benefit under this Section 2.5 is an amount equal to the benefit detailed on Schedule A payable annually for fifteen (15) years commencing upon the first month after attaining age 65.

2.5.2 *Payment of Benefit.* The Employer shall pay the benefit under this Section 2.5 to the Executive over fifteen (15) years in twelve (12) equal monthly installments payable annually on the first day of each month,

beginning with the month after the Executive reaches his Normal Retirement Age.

2.6 *Petition for Lump Sum Payment of Benefit.* If the Executive is entitled to a benefit under Section 2.1, Section 2.2, Section 2.3, Section 2.4 or Section 2.5, the Executive may petition the Board of Directors of the Employer to have the Present Value of the Benefit, determined as of the date the Executive becomes entitled to a benefit under Section 2.1, Section 2.2, Section 2.3, Section 2.4 or Section 2.5, as applicable, paid to the Executive in a single lump sum. The Board of Directors of the Employer may, in its sole and absolute discretion, pay the Present Value of the Benefit to the Executive in a single lump sum. If the Present Value of the Benefit is paid to the Executive in a single lump sum, the Employer shall have no further obligations under this Agreement.

2.7 *Excess Parachute Payment.* If the Executive receives the payment pursuant to Section 2.4 and acceleration of benefits under any other benefit, compensation, or incentive plan or arrangement with the Bank or its parent corporation (collectively, the "Total Benefits"), and if any part of the Total Benefits is subject to an excise tax under Section 280G and Section 4999 of the Code (the "Excise Tax"), the Bank shall pay to the Executive the following additional amounts, consisting of (*x*) a payment equal to the Excise Tax payable by the Executive under section 4999 on the Total Benefits (the "Excise Tax Payment") and (*y*) a payment equal to the amount necessary to provide the Excise Tax Payment net of all income, payroll, and excise taxes. Together, the additional amounts described in clauses (*x*) and (*y*) are referred to in this Agreement as the "Gross-Up Payment Amount." Payment of the Gross-Up Payment Amount shall be made in addition to the amount set forth in Section 2.4 above.

2.8 *Total Benefits Subject to Excise Tax.* For purposes of determining whether any of the Total Benefits will be subject to the Excise Tax and for purposes of determining the amount of the Excise Tax, any other payments or benefits received or to be received by the Executive in connection with a Change in Control or the Executive's termination of employment following a Change in Control (whether under the terms of this Agreement or any other agreement or any other benefit plan or arrangement with the Bank or its parent corporation) shall be treated as "parachute payments" within the meaning of section 280G(b)(2) of the Code, and all "excess parachute payments" within the meaning of section 280G(b)(1) shall be treated as subject to the Excise Tax, unless in the opinion of the certified public accounting firm that is retained by the Bank as of the date immediately before the Change in Control (the "Accounting Firm"), such other payments or benefits do not constitute (in whole or in part) parachute payments, or such excess parachute payments represent (in whole or in part) reasonable compensation for services actually rendered within the meaning of section 280G(b)(4) of the Code in excess of the "base amount" (as defined in section 280G(b)(3) of the Code), or are otherwise not subject to the Excise Tax. The value of any noncash benefits or any deferred payment or benefit shall be determined by the Accounting Firm in accordance with the principles of sections 280G(d)(3) and (4) of the Code.

2.9 *Gross Up Payment Amount.* For purposes of determining the Gross-Up Payment Amount, the Executive shall be deemed to pay federal income taxes at the highest marginal rate of federal income taxation in the calendar years in which the Gross-Up Payment Amount is to be made and state and local income taxes at the highest marginal rate of taxation in the state and locality of the Executive's residence on the date of termination of employment, net of the

reduction in federal income taxes that can be obtained from deduction of such state and local taxes (calculated by assuming that any reduction under section 68 of the Code in the amount of itemized deductions allowable to the Executive applies first to reduce the amount of such state and local income taxes that would otherwise be deductible by the Executive, and applicable federal FICA and Medicare withholding taxes).

2.10 *Determination by Accounting Firm.* All determinations required to be made under Section 2.7, Section 2.8 and Section 2.9, including whether and when a Gross-Up Payment Amount is required, the amount of the Gross-Up Payment Amount and the assumptions to be used to arrive at the determination (collectively, the "Determination"), shall be made by the Accounting Firm, which shall provide detailed supporting calculations both to the Bank and the Executive within 15 business days after receipt of notice from the Bank or the Executive that there has been a Gross-Up Payment Amount, or such earlier time as is requested by the Bank. All fees and expenses of the Accounting Firm shall be borne solely by the Bank. The Bank shall enter into any reasonable agreement requested by the Accounting Firm in connection with the performance of its services hereunder. If the Accounting Firm determines that no Excise Tax is payable by the Executive, the Accounting Firm shall furnish the Executive with a written opinion to that effect, and to the effect that failure to report an Excise Tax, if any, on the Executive's applicable federal income tax return will not result in the imposition of a negligence or similar penalty. The Determination by the Accounting Firm shall be binding on the Bank and the Executive. If, after a Determination by the Accounting Firm, the Executive is required to make a payment of additional Excise Tax ("Underpayment"), the Accounting Firm shall determine the amount of the Underpayment that has occurred. The Underpayment (together with interest at the rate provided in section 1274(d)(2)(B) of the Code) shall be paid promptly by the Bank to or for the benefit of the Executive. If the Gross-Up Payment Amount exceeds the amount necessary to reimburse the Executive for his Excise Tax ("Overpayment"), the Accounting Firm shall determine the amount of the Overpayment that has been made. The Overpayment (together with interest at the rate provided in section 1274(d)(2)(B) of the Code) shall be paid promptly by the Executive to or for the benefit of the Bank. Provided that his expenses are reimbursed by the Bank, the Executive shall cooperate with any reasonable requests by the Bank in any contests or disputes with the Internal Revenue Service relating to the Excise Tax. If the Accounting Firm is serving as accountant or auditor for the individual, entity, or group effecting the Change in Control, the Executive, in his sole discretion, may appoint another nationally recognized public accounting firm to make the Determinations required hereunder (in which case the term "Accounting Firm" as used in this Agreement shall be deemed to refer to the accounting firm appointed by the Executive under this Section).

2.11 *Contradiction in Terms of Agreement and Schedule A.* If there is a contradiction in the terms of this Agreement and Schedule A attached hereto concerning the actual amount of a particular benefit amount due the Executive under Sections 2.2, 2.3, 2.4 or 2.5 hereof, then the actual amount of the benefit set forth in the Agreement shall control.

2.12 *One Benefit Only.* Despite any contrary provision of this Agreement, the Executive and Beneficiary are entitled to one benefit only under Article 2 of this Agreement, which shall be determined by the first event to occur that is dealt with by Article 2 of this Agreement. Subsequent occurrence of events dealt with by this Article 2 shall not entitle the Executive or the Executive's Beneficiary to other or additional benefits under Article 2.

2.13 *Savings Clause Relating to Compliance with Code Section 409A.* Despite any contrary provision of this Agreement, if when the Executive's employment terminates the Executive is a specified employee, as defined in Code section 409A, and if any payments under Article 2 of this Agreement will result in additional tax or interest to the Executive because of section 409A, the Executive will not be entitled to the payments under Article 2 until the earliest of (a) the date that is at least six months after termination of the Executive's employment for reasons other than the Executive's death, (b) the date of the Executive's death, or (c) any earlier date that does not result in additional tax or interest to the Executive under section 409A. If any provision of this Agreement would subject the Executive to additional tax or interest under section 409A, the Bank shall reform the provision. However, the Bank shall maintain to the maximum extent practicable the original intent of the applicable provision without subjecting the Executive to additional tax or interest, and the Bank shall not be required to incur any additional compensation expense as a result of the reformed provision. References in this Agreement to Code section 409A include rules, regulations, and guidance of general application issued by the Department of the Treasury under Code section 409A.

3
DEATH BENEFITS

3.1 *Death During Active Service.* If the Executive dies while employed by the Employer, instead of any benefits payable under Article 2 of this Agreement the Employer shall pay to the Executive's Beneficiary the present value of the amount necessary to provide the full benefit described in section 2.1.1 and identified on Schedule A. The Employer shall pay the death benefit under this Section 3.1 within thirty (30) days after the Executive's death.

3.2 *Death During Benefit Period.* If the Executive dies after benefit payments under Article 2 of this Agreement commences but before receiving all such payments, or if the Executive is entitled to benefit payments under Article 2 but dies before payments commence, the remaining Accrual Balance shall be payable to the Executive's Beneficiary in accordance with the applicable payment provisions of Article 2, until fully disbursed. Payments shall be made in the same amounts they would have been made to the Executive had the Executive survived.

4
BENEFICIARIES

4.1 *Beneficiary Designations.* The Executive shall have the right to designate at any time a Beneficiary to receive any benefits payable under this Agreement upon the death of the Executive. The Beneficiary designated under this Agreement may be the same as or different from the beneficiary designation under any other benefit plan of the Employer in which the Executive participates.

4.2 *Beneficiary Designation: Change.* The Executive shall designate a Beneficiary by completing and signing the Beneficiary Designation Form and delivering it to the Plan Administrator or its designated agent. The Executive's Beneficiary designation shall be deemed automatically revoked if the Beneficiary predeceases the Executive or if the Executive names a spouse as Beneficiary and the marriage is subsequently dissolved. The Executive shall have the right to change a Beneficiary by completing, signing, and otherwise complying with the terms of the Beneficiary Designation Form and the Plan Administrator's rules and procedures, as in effect

from time to time. Upon the acceptance by the Plan Administrator of a new Beneficiary Designation Form, all Beneficiary designations previously filed shall be cancelled. The Plan Administrator shall be entitled to rely on the last Beneficiary Designation Form filed by the Executive and accepted by the Plan Administrator before the Executive's death.

4.3 *Acknowledgment.* No designation or change in designation of a Beneficiary shall be effective until received in writing by the Plan Administrator or its designated agent.

4.4 *No Beneficiary Designation.* If the Executive dies without a valid beneficiary designation, or if all designated Beneficiaries predecease the Executive, then the Executive's spouse shall be the designated Beneficiary. If the Executive has no surviving spouse, the benefits shall be distributed to the personal representative of the Executive's estate.

4.5 *Facility of Payment.* If a benefit is payable to a minor, to a person declared incapacitated, or to a person incapable of handling the disposition of his or her property, the Employer may pay such benefit to the guardian, legal representative, or person having the care or custody of the minor, incapacitated person, or incapable person. The Employer may require proof of incapacity, minority, or guardianship as it may deem appropriate before distribution of the benefit. Distribution shall completely discharge the Employer from all liability for the benefit.

5
GENERAL LIMITATIONS

5.1 *Termination for Cause.* If the Executive experiences a Termination of Employment which is a Termination for Cause, notwithstanding any provision of this Agreement to the contrary, this Agreement and the Employer's obligations under this Agreement shall terminate as of the effective date of the Termination for Cause.

5.2 *Suicide or Misstatement* No benefits shall be paid under this Agreement if the Executive commits suicide within two years after the Effective Date of this Agreement or if the Executive makes any material misstatement of fact on any application for life insurance purchased by the Bank.

5.3 *Removal.* Despite any contrary provision of this Agreement, if the Executive is removed from office or permanently prohibited from participating in the Bank's affairs by an order issued under section 8(e) (4) or (g) (1) of the Federal Deposit Insurance Act, 12 U.S.C. 1818(e) (4) or (g) (1), all obligations of the Bank under this Agreement shall terminate as of the effective date of the order.

5.4 *Default* Despite any contrary provision of this Agreement, if the Bank is in "default" or "in danger of default", as those terms are defined in of section 3(x) of the Federal Deposit Insurance Act, 12 U.S.C. 1813(x), all obligations under this Agreement shall terminate.

5.5 *FDIC Open-Bank Assistance.* All obligations under this Agreement shall be terminated, except to the extent determined that continuation of the contract is necessary for the continued operation of the Bank, at the time the Federal Deposit Insurance Corporation enters into an agreement to provide assistance to or on behalf of the Bank under the authority contained in section 13(c) of the Federal Deposit Insurance Act. 12 U.S.C. 1823(c).

6
CLAIMS AND REVIEW PROCEDURES

6.1 *Claims Procedure.* A person or beneficiary (a "claimant") who has not received benefits under the Agreement that he or she believes should be paid shall make a claim for such benefits as follows –

6.1.1 *Initiation — Written Claim.* The claimant initiates a claim by submitting to the Employer a written claim for the benefits. If the claim relates to the contents of a notice received by the claimant, the claim must be made within 60 days after the notice was received by the claimant. All other claims must be made within 180 days after the date of the event that caused the claim to arise. The claim must state with particularity the determination desired by the claimant.

6.1.2 *Timing of Employer Response.* The Employer shall respond to such claimant within ninety (90) days after receiving the claim. If the Employer determines that special circumstances require additional time for processing the claim, the Employer can extend the response period by an additional ninety (90) days by notifying the claimant in writing, prior to the end of the initial ninety (90)-day period, that an additional period is required. The notice of extension must set forth the special circumstances and the date by which the Employer expects to render its decision.

6.1.3 *Notice of Decision.* If the Employer denies part or all of the claim, the Employer shall notify the claimant in writing of such denial. The Employer shall write the notification in a manner calculated to be understood by the claimant. The notification shall set forth:

6.1.3.1 The specific reasons for the denial,

6.1.3.2 A reference to the specific provisions of the Agreement on which the denial is based,

6.1.3.3 A description of any additional information or material necessary for the claimant to perfect the claim and an explanation of why it is needed,

6.1.3.4 An explanation of the Agreement’s review procedures and the time limits applicable to such procedures, and

6.1.3.5 A statement of the claimant’s right to bring a civil action under ERISA section 502(a) following an adverse benefit determination on review.

6.2 *Review Procedure*. If the Employer denies part or all of the claim, the claimant shall have the opportunity for a full and fair review by the Employer of the denial, as follows

6.2.1 *Initiation — Written Request.* To initiate the review, the claimant, within 60 days after receiving the Employer's notice of denial, must file with the Employer a written request for review.

6.2.2 *Additional Submissions — Information Access.* The claimant shall then have the opportunity to submit written comments, documents, records and other information relating to the claim. The Employer shall also provide the claimant, upon request and free of charge, reasonable access to, and copies of, all documents, records and other information relevant (as defined in applicable ERISA regulations) to the claimant's claim for benefits.

6.2.3 *Considerations on Review.* In considering the review, the Employer shall take into account all materials and information the claimant submits relating to the claim, without regard to whether such information was submitted or considered in the initial benefit determination.

6.2.4 *Timing of Employer Response.* The Employer shall respond in writing to such claimant within sixty (60) days after receiving the request for review. If the Employer determines that special circumstances require additional time for processing the claim, the Employer can extend the response period by an additional sixty (60) days by notifying the claimant in writing, prior to the end of the initial sixty (60)-day period, that an additional period is required. The notice of extension must set forth the special circumstances and the date by which the Employer expects to render its decision.

6.2.5 *Notice of Decision.* The Employer shall notify the claimant in writing of its decision on review. The Employer shall write the notification in a manner calculated to be understood by the claimant. The notification shall set forth –

6.2.5.1 The specific reasons for the denial,

6.2.5.2 A reference to the specific provisions of the Agreement on which the denial is based,

6.2.5.3 A statement that the claimant is entitled to receive, upon request and free of charge, reasonable access to, and copies of, all documents, records and other information relevant (as defined in applicable ERISA regulations) to the claimant's claim for benefits, and

6.2.5.4 A statement of the claimant's right to bring a civil action under ERISA Section 502(a).

7
MISCELLANEOUS

7.1 *Amendments and Termination.* Subject to Section 7.13 of this Agreement, (a) this Agreement may be amended solely by a written agreement signed by the Employer and by the Executive, and (b) except for termination occurring under Article 5, this Agreement may be

terminated solely by a written agreement signed by the Employer and by the Executive.

7.2 *Binding Effect.* This Agreement shall bind the Executive and the Employer and their beneficiaries, survivors, executors, successors, administrators, and transferees.

7.3 *No Guarantee of Employment.* This Agreement is not an employment policy or contract. It does not give the Executive the right to remain an employee of the Employer, nor does it interfere with the Employer's right to discharge the Executive. It also does not require the Executive to remain an employee nor interfere with the Executive's right to terminate employment at any time.

7.4 *Non-Transferability.* Benefits under this Agreement cannot be sold, transferred, assigned, pledged, attached, or encumbered in any manner.

7.5 *Tax Withholding.* The Employer shall withhold any taxes that are required to be withheld from the benefits provided under this Agreement.

7.6 *Applicable Law.* Except to the extent preempted by the laws of the United States of America, the validity, interpretation, construction, and performance of this Agreement shall be governed by and construed in accordance with the laws of the State of North Carolina, without giving effect to the principles of conflict of laws of such state.

7.7 *Unfunded Arrangement.* The Executive and the Executive's Beneficiary are general unsecured creditors of the Employer for the payment of benefits under this Agreement. The benefits represent the mere promise by the Employer to pay such benefits. The rights to benefits are not subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance, attachment, or garnishment by creditors. Any insurance on the Executive's life is a general asset of the Employer to which the Executive and Beneficiary have no preferred or secured claim.

7.8 *Severability.* If any provision of this Agreement is held invalid, such invalidity shall not affect any other provision of this Agreement, and each such other provision shall continue in full force and effect to the full extent consistent with law. If any provision of this Agreement is held invalid in part, such invalidity shall not affect the remainder of the provision, and the remainder of such provision together with all other provisions of this Agreement shall continue in full force and effect to the full extent consistent with law.

7.9 *Headings.* The headings of sections herein are included solely for convenience of reference and shall not affect the meaning or interpretation of any provision of this Agreement.

7.10 *Notices.* All notices, requests, demands, and other communications hereunder shall be in writing and shall be deemed to have been duly given if delivered by hand or mailed, certified or registered mail, return receipt requested, with postage prepaid. Unless otherwise changed by notice, notice shall be properly addressed to the Executive if addressed to the address of the Executive on the books and records of the Employer at the time of the delivery of such notice, and properly addressed to the Employer if addressed to the Board of Directors, at 1145 North Road Street, Elizabeth City, North Carolina 27909.

7.11 *Entire Agreement.* This Agreement constitutes the entire agreement between the Employer and the Executive concerning the subject matter hereof. No rights are granted to the Executive under this Agreement other than those specifically set forth herein.

7.12 *Payment of Legal Fees.* In the event litigation ensues between the parties concerning the enforcement of the obligations of the parties under this Agreement, the Employer shall pay all costs and expenses in connection with such litigation until such time as a final determination (excluding any appeals) is made with respect to the litigation. If the Employer prevails on the substantive merits of the each material claim in dispute in such litigation, the Employer shall be entitled to receive from the Executive all reasonable costs and expenses, including without limitation attorneys' fees, incurred by the Employer on behalf of the Executive in connection with such litigation, and the Executive shall pay such costs and expenses to the Employer promptly upon demand by the Employer.

7.13 *Termination or Modification of Agreement Because of Changes in Law, Rules or Regulations.* The Employer is entering into this Agreement on the assumption that certain existing tax laws, rules, and regulations will continue in effect in their current form. If that assumption materially changes and the change has a material detrimental effect on this Agreement, then the Employer reserves the right to terminate or modify this Agreement accordingly, subject to the written consent of the Executive, which shall not be unreasonably withheld. This Section 7.13 shall become null and void effective immediately if a Change in Control occurs.

8
ADMINISTRATION OF AGREEMENT

8.1 *Plan Administrator Duties.* This Agreement shall be administered by a Plan Administrator consisting of the Board of Directors of the Employer or such committee or person(s) as the Board of Directors of the Employer shall appoint. In accordance with the rules applicable for companies listed on the Nasdaq Stock Market and the Employer's corporate governance procedures, the Executive shall not serve as a member of the Plan Administrator. The Plan Administrator shall also have the discretion and authority to (a) make, amend, interpret, and enforce all appropriate rules and regulations for the administration of this Agreement and (b) decide or resolve any and all questions, including interpretations of this Agreement, as may arise in connection with the Agreement.

8.2 *Agents.* In the administration of this Agreement, the Plan Administrator may employ agents and delegate to them such administrative duties as it sees fit (including acting through a duly appointed representative) and may from time to time consult with counsel, who may be counsel to the Employer.

8.3 *Binding Effect of Decisions.* The decision or action of the Plan Administrator with respect to any question arising out of or in connection with the administration, interpretation, and application of the Agreement and the rules and regulations promulgated hereunder shall be final and conclusive and binding upon all persons having any interest in the Agreement. No Executive or Beneficiary shall be deemed to have any right, vested or nonvested, regarding the continued use of any previously adopted assumptions, including but not limited to the discount rate and calculation method described in Section 1.1.

8.4 *Indemnity of Plan Administrator.* The Plan Administrator shall not be liable to any person for any action taken or omitted in connection with the interpretation and administration of this Agreement, unless such action or omission is attributable to the willful misconduct of the Plan Administrator or any of its members. The Employer shall indemnify and hold harmless the members of the Plan Administrator against any and all claims, losses, damages, expenses, or liabilities arising from any action or failure to act with respect to this Agreement, except in the case of willful misconduct by the Plan Administrator or any of its members.

8.5 *Employer Information*. To enable the Plan Administrator to perform its functions, the Employer shall supply full and timely information to the Plan Administrator on all matters relating to the date and circumstances of the retirement, Disability, death, or Termination of Employment of the Executive and such other pertinent information as the Plan Administrator may reasonably require.

IN WITNESS WHEREOF, the Executive and a duly authorized Executive of the Company and the Bank have signed this Agreement as of the date first written above.

THE EXECUTIVE:	**THE BANK:** **Gateway Bank & Trust Co.**
/s/ D. Ben Berry	By: /s/ David R. Twiddy
D. Ben Berry	Its: President

BENEFICIARY DESIGNATION
SALARY CONTINUATION AGREEMENT

I, _________., designate the following as beneficiary of any death benefits under this Salary Continuation Agreement –

Primary: ____

____ .

Contingent: ____

____

Note: To name a trust as beneficiary, please provide the name of the trustee(s) and the exact name and date of the trust agreement.

I understand that I may change these beneficiary designations by filing a new written designation with the Employer. I further understand that the designations will be automatically revoked if the beneficiary predeceases me, or if I have named my spouse as beneficiary and our marriage is subsequently dissolved.

Signature: ________________________
Daniel Berry

Date:__________________, 2006

Accepted by the Employer this _________ day of __________________, 2006.

By: ________________________

Print Name:________________________

Title: ________________________

SCHEDULE A

Plan Year	Plan Year ending December 31,	Annual Retirement Fixed Benefit	Termination without Cause annual benefit payable at Normal Retirement Age	Disability annual benefit payable at Normal Retirement Age	Change in Control Annual Benefit Payable at Normal Retirement Age	Accrual Balance	Premature Death Benefit
1	2006	367,500	651,282	0	651,282	60,777	2,936,040
2	2007	384,038	651,282	30,824	651,282	321,824	3,104,862
3	2008	401,319	651,282	58,760	651,282	613,484	3,283,392
4	2009	419,379	651,282	89,886	651,282	938,461	3,472,187
5	2010	438,251	651,282	124,483	651,282	1,299,674	3,671,837
6	2011	457,972	651,282	162,852	651,282	1,700,266	3,882,968
7	2012	478,581	651,282	205,317	651,282	2,143,631	4,106,239
8	2013	500,117	651,282	252,229	651,282	2,633,421	4,342,348
9	2014	522,622	651,282	303,965	651,282	3,173,573	4,592,033
10	2015	546,140	651,282	360,931	651,282	3,768,327	4,856,074
11	2016	570,716	651,282	423,564	651,282	4,422,247	5,135,299
12	2017	596,398	651,282	492,334	651,282	5,140,247	5,430,578
13	2018	623,236	651,282	567,748	651,282	5,927,613	5,742,837
	1-Dec	651,282					6,073,050

Section 9: EX-10.9 (EXHIBIT 10.9)

Exhibit 10.9

SALARY CONTINUATION AGREEMENT

THIS SALARY CONTINUATION AGREEMENT (this "Agreement") is entered into as of this first day of October 1, 2006 by and between **GATEWAY BANK & TRUST CO.,** a North Carolina banking corporation (hereinafter referred to as the "Bank" or "Employer") and **DAVID R. TWIDDY**, an individual resident of North Carolina (hereinafter referred to as the "Executive").

WHEREAS, the Executive has contributed substantially to the success of the Employer and the Employer desires that the Executive continue in its employ;

WHEREAS, to encourage the Executive to remain an employee of the Employer, the Employer is willing to provide salary continuation benefits to the Executive, payable out of the Employer's general assets; and

WHEREAS, the parties hereto intend that this Agreement shall be considered an unfunded arrangement maintained primarily to provide supplemental retirement benefits for the Executive, and shall be considered a plan described in Section 301(a)(3) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA").

NOW THEREFORE, in consideration of the foregoing premises and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows.

ARTICLE 1
DEFINITIONS

Whenever used in this Agreement, the following terms have the meanings specified —

1.1 *"Accrual Balance"* means the liability that should be accrued by the Employer under accounting principles generally accepted in the United States ("GAAP") for the Employer's obligation to the Executive under this Agreement, by applying Accounting Principles Board Opinion No. 12, as amended by Statement of Financial Accounting Standards No. 106, and the calculation method and discount rate specified hereinafter. The Accrual Balance shall be determined by the liability accrued by the Bank as of the Effective Date. The projected Accrual Balance is detailed on Schedule A including annual accruals. The Accrual Balance shall be calculated assuming a level principal amount and interest as the discount rate is accrued each period. The principal accrual is determined such that when it is credited with interest each month, the Accrual Balance at Normal Retirement Age equals the present value of the normal retirement benefits described in Section 2.1.1(a) and (b). At the end of each Plan Year, the Accrual Balance shall be adjusted to reflect the Employer's obligation under Sections 2.1.1(a) in terms of the Executive's actual base salary for that Plan Year. The discount rate means the rate used by the Plan Administrator for determining the Accrual Balance. The rate is based on the yield on a 20-year corporate bond rated Aa by Moody's, rounded to the nearest 1/4%, or as otherwise determined by the governing Regulatory body. The initial discount rate is 5.75%. In its sole discretion, the Plan Administrator may adjust the discount rate to maintain the rate within reasonable standards according to GAAP and consistent with the Interagency Advisory on Accounting for Deferred Compensation Agreements which states that the "cost of those benefits shall be accrued over that period of the employee's service in a systematic and rational manner."

1.2 *"Beneficiary"* means each designated person, or the estate of the deceased Executive, entitled to benefits, if any, upon the death of the Executive, determined according to Article 4.

1.3 *"Beneficiary Designation Form"* means the form established from time to time by the Plan Administrator that the Executive completes, signs, and returns to the Plan Administrator to designate one or more Beneficiaries.

1.4 *"Change in Control"* For the purposes of this Agreement, the term Change in Control shall mean a change in control as defined in Section 409A of the Code, including any of the following events:

(i) Any person, or more than one person acting as a group, accumulates ownership of the common stock of Gateway Financial Holdings, Inc. ("Gateway Financial") constituting more than 50% of the total fair market value or total voting power of Gateway Financial's common stock,

(ii) Any person, or more than one person acting as a group, acquires within a 12-month period ownership of Gateway Financial's common stock possessing 30% or more of the total voting power of Gateway Financial's common stock;

(iii) A majority of Gateway Financial's Board of Directors is replaced during any 12-month period by directors whose appointment or election is not endorsed in advance by a majority of Gateway Financial's Board of Directors before the date of appointment or election, or

(iv) Within a 12-month period, any person, or more than one person acting as a group, acquires assets from Gateway Financial having a total gross fair market value equal to or exceeding 40% of the total gross fair market value of all of the assets of Gateway Financial immediately before the acquisition or acquisitions. For this purpose, "gross fair market value" means the value of Gateway Financial's assets, or the value of the assets being disposed of, determined without regard to any liabilities associated with the assets

Persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase, or acquisition of stock, or a similar transaction, involving Gateway Financial. Notwithstanding the other provisions of this Section 1.4, a transaction or event shall not be considered a Change in Control if, prior to the consummation or occurrence of such transaction or event, Executive and Bank agree in writing that the same shall not be treated as a Change in Control for purposes of this Agreement.

1.4A *"Code"*means the Internal Revenue Code of 1986, as amended.

1.5 *"Disability"* means the Executive suffers a sickness, accident or injury that is determined by the carrier of any individual or group disability insurance policy covering the Executive to be a disability rendering the Executive totally and permanently disabled, as certified by a physician chosen by the Employer and reasonably acceptable to the Executive, or as later defined by the Internal Revenue Service in IRS Notice 2005 — 1.

1.6 *"Early Retirement Date"* means the date of the Executive's Termination of Employment with the Employer for reasons other than death, Disability, Termination for Cause, termination under Article *5* of this Agreement, or within twenty-four (24) months after a Change

in Control, provided, however, that an Early Retirement Date may only occur following the later of the date the Executive attains age sixty-two (62) or the date the Executive has been continuously employed by the Employer for ten (10) years.

1.7 *"Effective Date"* means October 1, 2006.

1.8 *"Final Average Salary"* means the Executive's average annual base salary for the three year period ending at Executive's Normal Retirement Date.

1.9 *"Good Reason"* shall mean any of the following events:

(i) Executive is assigned any duties and/or responsibilities that, in Executive's reasonable determination, are inconsistent with or constitute a demotion or reduction in the Executive's position, duties, responsibilities or status as such existed at the time of the Change in Control or with his reporting responsibilities or titles with the Bank in effect at such time, regardless of Executive's resulting position; or

(ii) Executive's annual base salary rate is reduced below the annual amount in effect as of the effective date of a Change in Control or as the same shall have been increased from time to time following such effective date; or

(iii) Executive's life insurance, medical or hospitalization insurance, disability insurance, stock options plans, stock purchase plans, deferred compensation plans, management retention plans, retirement plans or similar plans or benefits being provided by the Bank to the Executive as of the effective date of the Change in Control are reduced in their level, scope or coverage, or any such insurance, plans or benefits are eliminated, unless such reduction or elimination applies proportionately to all salaried employees of the Bank who participated in such benefits prior to such Change in Control; or

(iv) Executive is transferred to a location which is more than 15 miles from his current principal work location without the Executive's express written consent.

1.10 *"Normal Retirement Age"* means age sixty-five (65).

1.11 *"Normal Retirement Date"* means the date of the Executive's Termination of Employment on or after the Executive reaches Normal Retirement Age, other than a Termination of Employment due to the Executive's death or due to a Termination for Cause.

1.12 *"Person"* means an individual, corporation, partnership, trust, association, joint venture, pool, syndicate, sole proprietorship, unincorporated organization or other entity.

1.13 *"Plan Administrator"* means the plan administrator described in Article 8.

1.14 *"Plan Year"* means a twelve-month period commencing on January 1, and ending on December 31 of each year. The initial Plan Year shall commence on the Effective Date of this Agreement and end on December 31 of the year in which occurs the Effective Date.

1.15 *"Regulatory Body"* refers to The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS), also known as "the agencies".

1.16 *"Termination for Cause"* and *"Cause"* shall have the same definition specified in any effective severance or employment agreement existing on the date hereof or hereafter entered into between the Executive and the Bank. If the Executive is not a party to a severance or employment agreement containing a definition of termination for cause, Termination for Cause means the Bank terminates the Executive's employment because of:

(a) the Executive's gross negligence or gross neglect of duties or intentional and material failure to perform stated duties after written notice thereof, or

(b) disloyalty or dishonesty by the Executive in the performance of his duties, or a breach of the Executive's fiduciary duties for personal profit, in any case whether in his capacity as a director or officer, or

(c) intentional wrongful damage by the Executive to the business or property of the Bank or its affiliates, including without limitation the reputation of the Bank, which in the judgment of the Bank causes material harm to the Bank or affiliates, or

(d) a willful violation by the Executive of any applicable law or significant policy of the Bank or an affiliate that, in the Bank's judgment, results in an adverse effect on the Bank or the affiliate, regardless of whether the violation leads to criminal prosecution or conviction. For purposes of this Agreement, applicable laws include any statute, rule, regulatory order, statement of policy, or final cease-and-desist order of any governmental agency or body having regulatory authority over the Bank, or

(e) the occurrence of any event that results in the Executive being excluded from coverage, or having coverage limited for the Executive as compared to other executives of the Bank, under the Bank's blanket bond or other fidelity or insurance policy covering its directors, officers, or employees, or

(f) the Executive is removed from office or permanently prohibited from participating in the Bank's affairs by an order issued under section 8(e) (4) or section 8(g) (1) of the Federal Deposit Insurance Act, 12 U.S.C. 1818(e) (4) or (g)(1), or

(g) conviction of the Executive for or plea of nolo contendere to a felony or conviction of or plea of nolo contendere to a misdemeanor involving moral turpitude, or the actual incarceration of the Executive for 45 consecutive days or more.

1.17 *"Termination of Employment"* with the Employer means that the Executive shall have ceased to be employed by the Employer for any reason whatsoever, excepting a leave of absence approved by the Employer. For purposes of this Agreement, if there is a dispute over the employment status of the Executive or the date of termination of the Executive's employment, the Employer shall have the sole and absolute right to decide the dispute.

ARTICLE 2
RETIREMENT BENEFITS

2.1 *Normal Retirement Benefit.* Upon the Executive's Termination of Employment on or after Normal Retirement Age for reason other than death, the Executive shall be eligible to receive the benefit described in this Section 2.1 in lieu of any other benefit under Article 2 of this Agreement provided no Change in Control benefit or Termination benefit has been paid as specified in Section 2.6.

2.1.1. *Amount of Benefit.* The amount of the annual benefit shall be equal to the following:

(a) *Fixed Benefit.* The annual benefit under this Section 2.1(a) is an amount equal to the benefit detailed on Schedule A payable annually for fifteen (15) years commencing upon the first month after attaining age 65.

(b) *Variable Benefit.* The variable benefit under this Section 2.1 (b) is an amount equal to seventy percent (70%) of the Executive's Final Average Salary, less the Fixed Benefit detailed on Schedule A, payable annually for fifteen (15) years commencing upon the first month after attaining age 65. If the benefit due under this Section 2.1 (b) is less than zero (0), then no benefit is payable under this Section 2.1 (b).

2.1.2. *Payment of Benefit.* The Employer shall pay the aggregate annual benefit described in Section 2.1.1 to the Executive over the remaining term in twelve (12) equal monthly installments payable on the first day of each month, beginning with the month after the Executive's Normal Retirement Date.

2.2 *Early Retirement Benefit.* Upon the Executive's Early Retirement Date, the Executive shall be eligible to receive the benefit described in this Section 2.2 in lieu of any other benefit under Article 2 of this Agreement.

2.2.1. *Amount of Benefit.* The annual benefit under this Section 2.2 is an amount equal to the Accrual Balance earned as of the last day of the Plan Year immediately preceding the Executive's Early Retirement Date.

2.2.2. *Payment of Benefit.* The Employer shall pay the early retirement benefit to the Executive over fifteen (15) years in twelve (12) equal monthly installments payable annually on the first day of each month, beginning with the month after the Executive reaches his Normal Retirement Age.

2.3 *Disability Benefit.* Upon the Executive's Termination of Employment due to a Disability before reaching Normal Retirement Age, the Executive shall be eligible to receive the benefit described in this Section 2.3 in lieu of any other benefit under this Agreement.

2.3.1. *Amount of Benefit.* The annual benefit under this Section 2.3 is an amount equal to the Accrual Balance earned as of the last day of the Plan Year immediately preceding the effective date of the Executive's Termination of Employment.

2.3.2. *Payment of Benefit.* The Employer shall pay the Disability benefit to the Executive over fifteen (15) years in twelve (12) equal monthly installments payable on the first day of each month, beginning with the month after the Executive's Normal Retirement Age.

2.4 *Change in Control Benefit.* If, within twenty-four (24) months after a Change in Control, the Employer terminates the Executive's employment other than for Cause or as described in Section 5.2 hereof or if the Executive terminates employment for Good Reason, the Executive shall be eligible to receive the benefit described in this Section 2.4 instead of any other benefit under Article 2 of this Agreement.

2.41 *Amount of Benefit.* The annual benefit under this Section 2.4 is an amount equal to seventy percent (70%) of the Executive's final annual salary at the Executive's Termination of Employment, or the benefit detailed on Schedule A, whichever is greater, payable annually for fifteen (15) years commencing as of the last day of the Plan Month preceding the effective date of the Executive's Termination of Employment.

2.41.1 *Payment of Benefit.* The Employer shall pay the Change in Control benefit under Section 2.4 of this Agreement to the Executive over fifteen (15) years in twelve (12) equal monthly installments payable on the first day of each month, beginning with the month after the Executive's Termination of Employment.

2.41.2 *Change in Control Payout of Normal Retirement Benefit, Early Retirement Benefit, or Disability Benefit Being Paid to the Executive at the Time of a Change in Control.* If a Change in Control occurs at any time during the period in which the Executive is receiving payment of the benefit under Section 2.1, 2.2, or 2.3, the Employer shall pay the remaining benefits due to the Executive under the applicable section to the Executive in a single lump sum payment within thirty (30) days after the Change in Control.

2.5 *Termination Benefit.* Upon the Executive's Termination without Cause by the Employer, the Executive shall be eligible to receive the benefit described in this Section 2.5 in lieu of any other benefit under Article 2 of this Agreement.

2.5.1 *Amount of Benefit.* The annual benefit under this Section 2.5 is an amount equal to the benefit detailed on Schedule A payable annually for fifteen (15) years commencing upon the first month after attaining age 65.

2.5.2 *Payment of Benefit.* The Employer shall pay the benefit under this Section 2.5 to the Executive over fifteen (15) years in twelve (12) equal monthly installments payable annually on the first day of each month, beginning with the month after the Executive reaches his Normal Retirement Age.

2.6 *Petition for Lump Sum Payment of Benefit.* If the Executive is entitled to a benefit under Section 2.1, Section 2.2, Section 2.3, Section 2.4 or Section 2.5, the Executive may petition the Board of Directors of the Employer to have the Present Value of the Benefit, determined as of the date the Executive becomes entitled to a benefit under Section 2.1, Section 2.2, Section 2.3, Section 2.4 or Section 2.5, as applicable, paid to the Executive in a single lump sum. The Board of Directors of the Employer may, in its sole and absolute discretion, pay the Present Value of the Benefit to the Executive in a single lump sum. If the Present Value of the Benefit is paid to the Executive in a single lump sum, the Employer shall have no further obligations under this Agreement.

2.7 *Excess Parachute Payment.* If the Executive receives the payment pursuant to Section 2.4 and acceleration of benefits under any other benefit, compensation, or incentive plan or arrangement with the Bank or its parent corporation (collectively, the "Total Benefits"), and if any part of the Total Benefits is subject to an excise tax under Section 280G and Section 4999 of the Code (the "Excise Tax"), the Bank shall pay to the Executive the following additional amounts, consisting of (*x*) a payment equal to the Excise Tax payable by the Executive under section 4999 on the Total Benefits (the "Excise Tax Payment") and (*y*) a payment equal to the amount necessary to provide the Excise Tax Payment net of all income, payroll, and excise taxes. Together, the additional amounts described in clauses (*x*) and (*y*) are referred to in this Agreement as the "Gross-Up Payment Amount." Payment of the Gross-Up Payment Amount shall be made in addition to the amount set forth in Section 2.4 above.

2.8 *Total Benefits Subject to Excise Tax.* For purposes of determining whether any of the Total Benefits will be subject to the Excise Tax and for purposes of determining the amount of the Excise Tax, any other payments or benefits received or to be received by the Executive in connection with a Change in Control or the Executive’s termination of employment following a Change in Control (whether under the terms of this Agreement or any other agreement or any other benefit plan or arrangement with the Bank or its parent corporation) shall be treated as "parachute payments" within the meaning of section 280G(b)(2) of the Code, and all "excess parachute payments" within the meaning of section 280G(b)(1) shall be treated as subject to the Excise Tax, unless in the opinion of the certified public accounting firm that is retained by the Bank as of the date immediately before the Change in Control (the "Accounting Firm"), such other payments or benefits do not constitute (in whole or in part) parachute payments, or such excess parachute payments represent (in whole or in part) reasonable compensation for services actually rendered within the meaning of section 280G(b)(4) of the Code in excess of the "base amount" (as defined in section 280G(b)(3) of the Code), or are otherwise not subject to the Excise Tax. The value of any noncash benefits or any deferred payment or benefit shall be determined by the Accounting Firm in accordance with the principles of sections 280G(d)(3) and (4) of the Code.

2.9 *Gross Up Payment Amount.* For purposes of determining the Gross-Up Payment Amount, the Executive shall be deemed to pay federal income taxes at the highest marginal rate of federal income taxation in the calendar years in which the Gross-Up Payment Amount is to be made and state and local income taxes at the highest marginal rate of taxation in the state and locality of the Executive’s residence on the date of termination of employment, net of the reduction in federal income taxes that can be obtained from deduction of such state and local taxes (calculated by assuming that any reduction under section 68 of the Code in the amount of itemized deductions allowable to the Executive applies first to reduce the amount of such state

and local income taxes that would otherwise be deductible by the Executive, and applicable federal FICA and Medicare withholding taxes).

2.10 *Determination by Accounting Firm.* All determinations required to be made under Section 2.7, Section 2.8 and Section 2.9, including whether and when a Gross-Up Payment Amount is required, the amount of the Gross-Up Payment Amount and the assumptions to be used to arrive at the determination (collectively, the "Determination"), shall be made by the Accounting Firm, which shall provide detailed supporting calculations both to the Bank and the Executive within 15 business days after receipt of notice from the Bank or the Executive that there has been a Gross-Up Payment Amount, or such earlier time as is requested by the Bank. All fees and expenses of the Accounting Firm shall be borne solely by the Bank. The Bank shall enter into any reasonable agreement requested by the Accounting Firm in connection with the performance of its services hereunder. If the Accounting Firm determines that no Excise Tax is payable by the Executive, the Accounting Firm shall furnish the Executive with a written opinion to that effect, and to the effect that failure to report an Excise Tax, if any, on the Executive's applicable federal income tax return will not result in the imposition of a negligence or similar penalty. The Determination by the Accounting Firm shall be binding on the Bank and the Executive. If, after a Determination by the Accounting Firm, the Executive is required to make a payment of additional Excise Tax ("Underpayment"), the Accounting Firm shall determine the amount of the Underpayment that has occurred. The Underpayment (together with interest at the rate provided in section 1274(d)(2)(B) of the Code) shall be paid promptly by the Bank to or for the benefit of the Executive. If the Gross-Up Payment Amount exceeds the amount necessary to reimburse the Executive for his Excise Tax ("Overpayment"), the Accounting Firm shall determine the amount of the Overpayment that has been made. The Overpayment (together with interest at the rate provided in section 1274(d)(2)(B) of the Code) shall be paid promptly by the Executive to or for the benefit of the Bank. Provided that his expenses are reimbursed by the Bank, the Executive shall cooperate with any reasonable requests by the Bank in any contests or disputes with the Internal Revenue Service relating to the Excise Tax. If the Accounting Firm is serving as accountant or auditor for the individual, entity, or group effecting the Change in Control, the Executive, in his sole discretion, may appoint another nationally recognized public accounting firm to make the Determinations required hereunder (in which case the term "Accounting Firm" as used in this Agreement shall be deemed to refer to the accounting firm appointed by the Executive under this Section).

2.11 *Contradiction in Terms of Agreement and Schedule A.* If there is a contradiction in the terms of this Agreement and Schedule A attached hereto concerning the actual amount of a particular benefit amount due the Executive under Sections 2.2, 2.3, 2.4 or 2.5 hereof, then the actual amount of the benefit set forth in the Agreement shall control.

2.12 *One Benefit Only.* Despite any contrary provision of this Agreement, the Executive and Beneficiary are entitled to one benefit only under Article 2 of this Agreement, which shall be determined by the first event to occur that is dealt with by Article 2 of this Agreement. Subsequent occurrence of events dealt with by this Article 2 shall not entitle the Executive or the Executive's Beneficiary to other or additional benefits under Article 2.

2.13 *Savings Clause Relating to Compliance with Code Section 409A.* Despite any contrary provision of this Agreement, if when the Executive's employment terminates the Executive is a specified employee, as defined in Code section 409A, and if any payments under

Article 2 of this Agreement will result in additional tax or interest to the Executive because of section 409A, the Executive will not be entitled to the payments under Article 2 until the earliest of (a) the date that is at least six months after termination of the Executive's employment for reasons other than the Executive's death, (b) the date of the Executive's death, or (c) any earlier date that does not result in additional tax or interest to the Executive under section 409A. If any provision of this Agreement would subject the Executive to additional tax or interest under section 409A, the Bank shall reform the provision. However, the Bank shall maintain to the maximum extent practicable the original intent of the applicable provision without subjecting the Executive to additional tax or interest, and the Bank shall not be required to incur any additional compensation expense as a result of the reformed provision. References in this Agreement to Code section 409A include rules, regulations, and guidance of general application issued by the Department of the Treasury under Code section 409A.

3
DEATH BENEFITS

3.1 *Death During Active Service.* If the Executive dies while employed by the Employer, instead of any benefits payable under Article 2 of this Agreement the Employer shall pay to the Executive's Beneficiary the present value of the amount necessary to provide the full benefit described in section 2.1.1 and identified on Schedule A. The Employer shall pay the death benefit under this Section 3.1 within thirty (30) days after the Executive's death.

3.2 *Death During Benefit Period.* If the Executive dies after benefit payments under Article 2 of this Agreement commences but before receiving all such payments, or if the Executive is entitled to benefit payments under Article 2 but dies before payments commence, the remaining Accrual Balance shall be payable to the Executive's Beneficiary in accordance with the applicable payment provisions of Article 2, until fully disbursed. Payments shall be made in the same amounts they would have been made to the Executive had the Executive survived.

4
BENEFICIARIES

4.1 *Beneficiary Designations.* The Executive shall have the right to designate at any time a Beneficiary to receive any benefits payable under this Agreement upon the death of the Executive. The Beneficiary designated under this Agreement may be the same as or different from the beneficiary designation under any other benefit plan of the Employer in which the Executive participates.

4.2 *Beneficiary Designation: Change.* The Executive shall designate a Beneficiary by completing and signing the Beneficiary Designation Form and delivering it to the Plan Administrator or its designated agent. The Executive's Beneficiary designation shall be deemed automatically revoked if the Beneficiary predeceases the Executive or if the Executive names a spouse as Beneficiary and the marriage is subsequently dissolved. The Executive shall have the right to change a Beneficiary by completing, signing, and otherwise complying with the terms of the Beneficiary Designation Form and the Plan Administrator's rules and procedures, as in effect from time to time. Upon the acceptance by the Plan Administrator of a new Beneficiary Designation Form, all Beneficiary designations previously filed shall be cancelled. The Plan Administrator shall be entitled to rely on the last Beneficiary Designation Form filed by the Executive and accepted by the Plan Administrator before the Executive's death.

4.3 *Acknowledgment.* No designation or change in designation of a Beneficiary shall be effective until received in writing by the Plan Administrator or its designated agent.

4.4 *No Beneficiary Designation.* If the Executive dies without a valid beneficiary designation, or if all designated Beneficiaries predecease the Executive, then the Executive's spouse shall be the designated Beneficiary. If the Executive has no surviving spouse, the benefits shall be distributed to the personal representative of the Executive's estate.

4.5 *Facility of Payment.* If a benefit is payable to a minor, to a person declared incapacitated, or to a person incapable of handling the disposition of his or her property, the Employer may pay such benefit to the guardian, legal representative, or person having the care or

custody of the minor, incapacitated person, or incapable person. The Employer may require proof of incapacity, minority, or guardianship as it may deem appropriate before distribution of the benefit. Distribution shall completely discharge the Employer from all liability for the benefit.

5
GENERAL LIMITATIONS

5.1 *Termination for Cause.* If the Executive experiences a Termination of Employment which is a Termination for Cause, notwithstanding any provision of this Agreement to the contrary, this Agreement and the Employer's obligations under this Agreement shall terminate as of the effective date of the Termination for Cause.

5.2 *Suicide or Misstatement* No benefits shall be paid under this Agreement if the Executive commits suicide within two years after the Effective Date of this Agreement or if the Executive makes any material misstatement of fact on any application for life insurance purchased by the Bank.

5.3 *Removal.* Despite any contrary provision of this Agreement, if the Executive is removed from office or permanently prohibited from participating in the Bank's affairs by an order issued under section 8(e) (4) or (g) (1) of the Federal Deposit Insurance Act, 12 U.S.C. 1818(e) (4) or (g) (1), all obligations of the Bank under this Agreement shall terminate as of the effective date of the order.

5.4 *Default* Despite any contrary provision of this Agreement, if the Bank is in "default" or "in danger of default", as those terms are defined in of section 3(x) of the Federal Deposit Insurance Act, 12 U.S.C. 1813(x), all obligations under this Agreement shall terminate.

5.5 *FDIC Open-Bank Assistance.* All obligations under this Agreement shall be terminated, except to the extent determined that continuation of the contract is necessary for the continued operation of the Bank, at the time the Federal Deposit Insurance Corporation enters into an agreement to provide assistance to or on behalf of the Bank under the authority contained in section 13(c) of the Federal Deposit Insurance Act. 12 U.S.C. 1823(c).

5.6 *Non-Competition*. All obligations under this Agreement shall be terminated, if during the period of one year after Termination of Employment, the Executive, within the "Restricted Area," directly or indirectly, engages in any business that competes with the Bank or any of its subsidiaries without the prior written consent of the Bank; provided, however, that the provisions of this Section shall not apply following Termination for Cause, or in the event the Executive terminates his employment with the Bank for Good Cause following a Change of Control. The Restricted Area covers the following divisible list of territories: Camden, Chowan, Currituck, Dare, Pasquotank, and Perquimans Counties, North Carolina and Chesapeake and Virginia Beach, Virginia, and within 15 miles of any Bank office operated during the term of this Agreement. Notwithstanding the foregoing, the Executive shall be free, without such consent, to purchase or hold as an investment or otherwise, up to five percent of the outstanding stock or other security of any corporation which has its securities publicly traded on any recognized securities exchange or in any over-the counter market.

6
CLAIMS AND REVIEW PROCEDURES

6.1 *Claims Procedure.* A person or beneficiary (a "claimant") who has not received benefits under the Agreement that he or she believes should be paid shall make a claim for such benefits as follows –

6.1.1 *Initiation — Written Claim.* The claimant initiates a claim by submitting to the Employer a written claim for the benefits. If the claim relates to the contents of a notice received by the claimant, the claim must be made within 60 days after the notice was received by the claimant. All other claims must be made within 180 days after the date of the event that caused the claim to arise. The claim must state with particularity the determination desired by the claimant.

6.1.2 *Timing of Employer Response.* The Employer shall respond to such claimant within ninety (90) days after receiving the claim. If the Employer determines that special circumstances require additional time for processing the claim, the Employer can extend the response period by an additional ninety (90) days by notifying the claimant in writing, prior to the end of the initial ninety (90)-day period, that an additional period is required. The notice of extension must set forth the special circumstances and the date by which the Employer expects to render its decision.

6.1.3 *Notice of Decision.* If the Employer denies part or all of the claim, the Employer shall notify the claimant in writing of such denial. The Employer shall write the notification in a manner calculated to be understood by the claimant. The notification shall set forth:

6.1.3.1 The specific reasons for the denial,

6.1.3.2 A reference to the specific provisions of the Agreement on which the denial is based,

6.1.3.3 A description of any additional information or material necessary for the claimant to perfect the claim and an explanation of why it is needed,

6.1.3.4 An explanation of the Agreement's review procedures and the time limits applicable to such procedures, and

6.1.3.5 A statement of the claimant's right to bring a civil action under ERISA section 502(a) following an adverse benefit determination on review.

6.2 *Review Procedure*. If the Employer denies part or all of the claim, the claimant shall have the opportunity for a full and fair review by the Employer of the denial, as follows

6.2.1 *Initiation — Written Request.* To initiate the review, the claimant, within 60 days after receiving the Employer's notice of denial, must file with the Employer a written request for review.

6.2.2 *Additional Submissions — Information Access.* The claimant shall then have the opportunity to submit written comments, documents, records and other information relating to the claim. The Employer shall also provide the claimant, upon request and free of charge, reasonable access to, and copies of, all documents, records and other information relevant (as defined in applicable ERISA regulations) to the claimant's claim for benefits.

6.2.3 *Considerations on Review.* In considering the review, the Employer shall take into account all materials and information the claimant submits relating to the claim, without regard to whether such information was submitted or considered in the initial benefit determination.

6.2.4 *Timing of Employer Response.* The Employer shall respond in writing to such claimant within sixty (60) days after receiving the request for review. If the Employer determines that special circumstances require additional time for processing the claim, the Employer can extend the response period by an additional sixty (60) days by notifying the claimant in writing, prior to the end of the initial sixty (60)-day period, that an additional period is required. The notice of extension must set forth the special circumstances and the date by which the Employer expects to render its decision.

6.2.5 *Notice of Decision.* The Employer shall notify the claimant in writing of its decision on review. The Employer shall write the notification in a manner calculated to be understood by the claimant. The notification shall set forth –

6.2.5.1 The specific reasons for the denial,

6.2.5.2 A reference to the specific provisions of the Agreement on which the denial is based,

6.2.5.3 A statement that the claimant is entitled to receive, upon request and free of charge, reasonable access to, and copies of, all documents, records and other information relevant (as defined in applicable ERISA regulations) to the claimant's claim for benefits, and

6.2.5.4 A statement of the claimant's right to bring a civil action under ERISA Section 502(a).

7

MISCELLANEOUS

7.1 *Amendments and Termination.* Subject to Section 7.13 of this Agreement, (a) this Agreement may be amended solely by a written agreement signed by the Employer and by the Executive, and (b) except for termination occurring under Article 5, this Agreement may be terminated solely by a written agreement signed by the Employer and by the Executive.

7.2 *Binding Effect.* This Agreement shall bind the Executive and the Employer and their beneficiaries, survivors, executors, successors, administrators, and transferees.

7.3 *No Guarantee of Employment.* This Agreement is not an employment policy or contract. It does not give the Executive the right to remain an employee of the Employer, nor does it interfere with the Employer's right to discharge the Executive. It also does not require the Executive to remain an employee nor interfere with the Executive's right to terminate employment at any time.

7.4 *Non-Transferability.* Benefits under this Agreement cannot be sold, transferred, assigned, pledged, attached, or encumbered in any manner.

7.5 *Tax Withholding.* The Employer shall withhold any taxes that are required to be withheld from the benefits provided under this Agreement.

7.6 *Applicable Law.* Except to the extent preempted by the laws of the United States of America, the validity, interpretation, construction, and performance of this Agreement shall be governed by and construed in accordance with the laws of the State of North Carolina, without giving effect to the principles of conflict of laws of such state.

7.7 *Unfunded Arrangement.* The Executive and the Executive's Beneficiary are general unsecured creditors of the Employer for the payment of benefits under this Agreement. The benefits represent the mere promise by the Employer to pay such benefits. The rights to benefits are not subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance, attachment, or garnishment by creditors. Any insurance on the Executive's life is a general asset of the Employer to which the Executive and Beneficiary have no preferred or secured claim.

7.8 *Severability.* If any provision of this Agreement is held invalid, such invalidity shall not affect any other provision of this Agreement, and each such other provision shall continue in full force and effect to the full extent consistent with law. If any provision of this Agreement is held invalid in part, such invalidity shall not affect the remainder of the provision, and the remainder of such provision together with all other provisions of this Agreement shall continue in full force and effect to the full extent consistent with law.

7.9 *Headings.* The headings of sections herein are included solely for convenience of reference and shall not affect the meaning or interpretation of any provision of this Agreement.

7.10 *Notices.* All notices, requests, demands, and other communications hereunder shall be in writing and shall be deemed to have been duly given if delivered by hand or mailed,

certified or registered mail, return receipt requested, with postage prepaid. Unless otherwise changed by notice, notice shall be properly addressed to the Executive if addressed to the address of the Executive on the books and records of the Employer at the time of the delivery of such notice, and properly addressed to the Employer if addressed to the Board of Directors, at 1145 North Road Street, Elizabeth City, North Carolina 27909.

7.11 *Entire Agreement.* This Agreement constitutes the entire agreement between the Employer and the Executive concerning the subject matter hereof. No rights are granted to the Executive under this Agreement other than those specifically set forth herein.

7.12 *Payment of Legal Fees.* In the event litigation ensues between the parties concerning the enforcement of the obligations of the parties under this Agreement, the Employer shall pay all costs and expenses in connection with such litigation until such time as a final determination (excluding any appeals) is made with respect to the litigation. If the Employer prevails on the substantive merits of the each material claim in dispute in such litigation, the Employer shall be entitled to receive from the Executive all reasonable costs and expenses, including without limitation attorneys' fees, incurred by the Employer on behalf of the Executive in connection with such litigation, and the Executive shall pay such costs and expenses to the Employer promptly upon demand by the Employer.

7.13 *Termination or Modification of Agreement Because of Changes in Law, Rules or Regulations.* The Employer is entering into this Agreement on the assumption that certain existing tax laws, rules, and regulations will continue in effect in their current form. If that assumption materially changes and the change has a material detrimental effect on this Agreement, then the Employer reserves the right to terminate or modify this Agreement accordingly, subject to the written consent of the Executive, which shall not be unreasonably withheld. This Section 7.13 shall become null and void effective immediately if a Change in Control occurs.

8
ADMINISTRATION OF AGREEMENT

8.1 *Plan Administrator Duties.* This Agreement shall be administered by a Plan Administrator consisting of the Board of Directors of the Employer or such committee or person(s) as the Board of Directors of the Employer shall appoint. In accordance with the rules applicable for companies listed on the Nasdaq Stock Market and the Employer's corporate governance procedures, the Executive shall not serve as a member of the Plan Administrator. The Plan Administrator shall also have the discretion and authority to (a) make, amend, interpret, and enforce all appropriate rules and regulations for the administration of this Agreement and (b) decide or resolve any and all questions, including interpretations of this Agreement, as may arise in connection with the Agreement.

8.2 *Agents.* In the administration of this Agreement, the Plan Administrator may employ agents and delegate to them such administrative duties as it sees fit (including acting through a duly appointed representative) and may from time to time consult with counsel, who may be counsel to the Employer.

8.3 *Binding Effect of Decisions.* The decision or action of the Plan Administrator with respect to any question arising out of or in connection with the administration,

interpretation, and application of the Agreement and the rules and regulations promulgated hereunder shall be final and conclusive and binding upon all persons having any interest in the Agreement. No Executive or Beneficiary shall be deemed to have any right, vested or nonvested, regarding the continued use of any previously adopted assumptions, including but not limited to the discount rate and calculation method described in Section 1.1.

8.4 *Indemnity of Plan Administrator.* The Plan Administrator shall not be liable to any person for any action taken or omitted in connection with the interpretation and administration of this Agreement, unless such action or omission is attributable to the willful misconduct of the Plan Administrator or any of its members. The Employer shall indemnify and hold harmless the members of the Plan Administrator against any and all claims, losses, damages, expenses, or liabilities arising from any action or failure to act with respect to this Agreement, except in the case of willful misconduct by the Plan Administrator or any of its members.

8.5 *Employer Information*. To enable the Plan Administrator to perform its functions, the Employer shall supply full and timely information to the Plan Administrator on all matters relating to the date and circumstances of the retirement, Disability, death, or Termination of Employment of the Executive and such other pertinent information as the Plan Administrator may reasonably require.

IN WITNESS WHEREOF, the Executive and a duly authorized Executive of the Company and the Bank have signed this Agreement as of the date first written above.

THE EXECUTIVE:	**THE BANK:** **Gateway Bank & Trust Co.**
/s/ David Twiddy David Twiddy	By: /s/ D. Ben Berry Its: Chief Executive Officer

BENEFICIARY DESIGNATION
SALARY CONTINUATION AGREEMENT

I, __________________., designate the following as beneficiary of any death benefits under this Salary Continuation Agreement –

Primary: ____ .

Contingent: ____

Note: To name a trust as beneficiary, please provide the name of the trustee(s) and the exact name and date of the trust agreement.

I understand that I may change these beneficiary designations by filing a new written designation with the Employer. I further understand that the designations will be automatically revoked if the beneficiary predeceases me, or if I have named my spouse as beneficiary and our marriage is subsequently dissolved.

Signature: ____
David Twiddy

Date: ____, 2006

Accepted by the Employer this ________ day of __________________, 2006.

By: ____

Print Name: ____

Title: ____

SCHEDULE A

Plan Year ending December 31,	Annual Retirement Fixed Benefit	Termination without Cause annual benefit payable at Normal Retirement Age	Disability annual benefit payable at Normal Retirement Age	Change in Control Annual Benefit Payable at Normal Retirement Age	Accrual Balance	Premature Death Benefit
2006	192,500	389,306	0	389,306	24,851	1,462,831
2007	201,163	389,306	5,506	389,306	131,591	1,546,944
2008	210,215	389,306	27,569	389,306	250,849	1,635,893
2009	219,674	389,306	49,697	389,306	383,730	1,729,957
2010	229,560	389,306	71,889	389,306	531,426	1,829,430
2011	239,890	389,306	94,146	389,306	695,226	1,934,622
2012	250,685	389,306	116,468	389,306	876,514	2,045,862
2013	261,966	389,306	138,854	389,306	1,076,785	2,163,500
2014	273,754	389,306	161,305	389,306	1,297,649	2,287,901
2015	286,073	389,306	183,821	389,306	1,540,839	2,419,455
2016	298,947	389,306	206,403	389,306	1,808,222	2,558,574
2017	312,399	389,306	229,049	389,306	2,101,806	2,705,692
2018	326,457	389,306	251,762	389,306	2,423,754	2,861,269
2019	341,148	389,306	274,540	389,306	2,776,391	3,025,792
2020	356,499	389,306	297,384	389,306	3,162,219	3,199,775
2021	372,542	389,306	320,293	389,306	3,583,927	3,383,762
1-Oct	389,306				3,578,328	3,578,328

Section 10: EX-10.10 (EXHIBIT 10.10)

Exhibit 10.10

CHANGE IN CONTROL AGREEMENT

THIS AMENDED AGREEMENT entered into as of October 1, 2007, by and between **GATEWAY BANK & TRUST CO.,** a North Carolina banking corporation (the "Bank") and **MATTHEW D. WHITE** (the "Employee")

For and in consideration of their mutual promises, covenants and conditions hereinafter set forth, and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties agree as follows:

1. **Term.** The initial term of this Agreement shall be for the period commencing upon June 1, 2007, and ending three calendar years from that date. On each anniversary of the commencement of the term of this Agreement, the term of this Agreement shall automatically be extended for an additional one year period beyond the then effective expiration date unless written notice from the Bank or the Employee is received 90 days prior to an anniversary date advising the other that this Agreement shall not be further extended; provided that the Bank shall review the Employee’s performance annually and make a specific determination pursuant to such review to renew this Agreement prior to the 90 days’ notice.

2. **Change in Control.** (a) In the event of a termination of the Employee’s employment with the Bank in connection with, or within twelve (12) months after, a "Change in Control" (as defined in Subparagraph (e) below), for reason of a Termination Event other than for "Cause" (as defined in Subparagraph (b) below), the Employee shall be entitled to receive from the Bank the amount set forth in Subparagraph (d) below. Said sum shall be payable as provided in Subparagraph (f) below.

(b) For purposes of this Agreement, termination for "Cause" shall include termination because of the Employee’s personal dishonesty, incompetence, willful misconduct, breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule, or regulation (other than traffic violations or similar offenses) or final cease-and-desist order.

(c) The Employee shall have the right to terminate employment with the Bank upon the occurrence of any of the following events (the "Termination Events") within twelve (12) months following a Change in Control:

(i) The Employee is assigned any duties and/or responsibilities that are inconsistent with the Employee’s position, duties, responsibilities or status at the time of the Change in Control or with the Employee’s reporting responsibilities or titles with the Bank in effect at such time; or

(ii) The Employee’s annual base salary rate is reduced below the annual amount in effect as of the effective date of a Change in Control or as the same shall have been increased from time to time following such effective date; or

(iii) The Employee’s life insurance, medical or hospitalization insurance, disability insurance, stock option plans, stock purchase plans, deferred compensation plans, management retention plans, retirement plans or similar plans or benefits being provided by the Bank to the Employee as of the effective date of the Change in Control are reduced in their level, scope or coverage, or any such insurance, plans or benefits are eliminated, unless such reduction or elimination applies proportionately to all salaried employees of the Bank who participated in such benefits prior to such Change in Control; or

(iv) The Employee is transferred to a location which is an unreasonable distance from the Employee’s current principal work location, without the Employee’s express written consent.

A Termination Event shall be deemed to have occurred on the date such action or event is implemented or takes effect.

(d) In the event that the Employee’s employment is terminated as set forth in Paragraph 2(a) or in the event that the Employee terminates employment pursuant to this Paragraph 2, the Bank will be obligated to pay or cause to be paid to the Employee an amount equal to one half (1/2) times the Employee’s annual "base amount" as defined in Section 280G(b)(3) of the Internal Revenue Code of 1986, as amended (the "Code").

(e) For the purpose of this Agreement, the term "Change in Control" shall mean:

(i) Any person, or more than one person acting as a group, accumulates ownership of the common stock of Gateway Financial Holdings, Inc. ("Gateway Financial") constituting more than 50% of the total fair market value or total voting power of Gateway Financial’s common stock,

(ii) Any person, or more than one person acting as a group, acquires within a 12-month period ownership of Gateway Financial’s common stock possessing 30% or more of the total voting power of Gateway Financial’s common stock;

(iii) A majority of Gateway Financial’s Board of Directors is replaced during any 12-month period by directors whose appointment or election is not endorsed in advance by a majority of Gateway Financial’s Board of Directors before the date of appointment or election, or

(iv) Within a 12-month period, any person, or more than one person acting as a group, acquires assets from Gateway Financial having a total gross fair market value equal to or exceeding 40% of the total gross fair market value of all of the assets of Gateway Financial immediately before the acquisition or acquisitions. For this purpose, "gross fair market value" means the value of Gateway Financial’s assets, or the value of the assets being disposed of, determined without regard to any liabilities associated with the assets

Persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase, or acquisition of stock, or a similar transaction, involving Gateway Financial. Notwithstanding the other provisions of this Paragraph 2, a transaction or event shall not be considered a Change in Control if, prior to the consummation or occurrence of such transaction or event, Employee and Bank agree in writing that the same shall not be treated as a Change in Control for purposes of this Agreement.

(f) Such amounts payable pursuant to this Paragraph 2 shall be paid, at the option of the Employee, either in one lump sum or in equal monthly payments over six months, such payment to be made, or to begin, by the end of the month following the date of termination.

(g) Following a Termination Event which gives rise to the Employee’s rights hereunder, the Employee shall have twelve (12) months from the date of the Change in Control to terminate employment with the Bank pursuant to this Paragraph 2. Any such termination shall be deemed to have occurred only upon delivery to the Bank (or to any successor corporation) of written notice of termination that describes the Change in Control and Termination Event. If the Employee does not so terminate employment within such twelve-month period following the date of the Change in Control, the Employee shall thereafter have no further rights, if any, hereunder.

(h) It is the intent of the parties hereto that all payments made pursuant to this Agreement be deductible by the Bank for federal income tax purposes and not result in the imposition of an excise tax on the Employee. Notwithstanding anything contained in this Agreement to the contrary, any payments to be made to or for the benefit of the Employee which are deemed to be "parachute payments" as that

term is defined in Section 280G of the Code shall be modified or reduced to the extent deemed to be necessary by the Bank's Board of Directors to avoid the imposition of excise taxes on the Employee under Section 4999 of the Code or the disallowance of a deduction to the Bank under Section 280G of the Code.

(i) In the event any dispute shall arise between the Employee and the Bank as to the terms or interpretation of this Agreement, including this Paragraph 2, whether instituted by formal legal proceedings or otherwise, including any action taken by the Employee to enforce the terms of this Paragraph 2 or in defending against any action taken by the Bank, the Bank shall reimburse the Employee for all costs and expenses incurred in such proceedings or actions, including reasonable attorney's fees, in the event the Employee prevails in any such action.

3. **Effect of Agreement on Employment Status of Employee.** This Agreement shall not confer on the Employee any right to employment with the Bank or to a position as an officer or an employee of the Bank, nor shall it limit the right of the Bank to remove the Employee from any position held by the Employee or to terminate the Employee's employment at any time.

4. **Successors and Assigns.** This Agreement shall inure to the benefit of and be binding upon any corporate or other successor of the Bank which shall acquire, directly or indirectly, by conversion, merger, consolidation, purchase or otherwise, all or substantially all of the assets of the Bank.

5. **Modification; Waiver; Amendments.** No provision of this Agreement may be modified, waived or discharged unless such modification, waiver or discharge is agreed to in writing and signed by the Employee and the Bank, except as herein otherwise provided. No waiver by either party hereto, at any time, of any breach by the other party hereto of, or compliance with a condition or provision of this Agreement to be performed by such other party, shall be deemed a waiver of similar or dissimilar provisions or conditions at the same or at any prior or subsequent time. No amendments or additions to this Agreement shall be binding unless in writing and signed by both parties, except as herein otherwise provided.

6. **Applicable Law.** This Agreement shall be governed in all respects whether as to validity, construction, capacity, performance or otherwise, by the law of North Carolina, except to the extent that federal law shall be deemed to apply.

7. **Severability.** The provisions of this Agreement shall be deemed severable and the invalidity or unenforceability of any provision shall not affect the validity or enforceability of the other provisions hereof.

8. **Previous Agreement**. This Agreement replaces the change in control compensation agreement between the Officer and The Bank of Richmond, N.A., the predecessor of the Bank, dated October 20, 2006.

[Signatures are on the following page.]

IN WITNESS WHEREOF, the parties have amended this Agreement as of the day and year first written above.

GATEWAY BANK & TRUST CO.

By: /s/ David R. Twiddy
David R. Twiddy, President

EMPLOYEE

/s/ Matthew D. White
Matthew D. White

Section 11: EX-21 (EXHIBIT 21)

Exhibit 21
Subsidiaries

Name	State of Incorporation
Gateway Bank & Trust Co.	North Carolina
Gateway Capital Statutory Trust I	Connecticut
Gateway Capital Statutory Trust II	Delaware
Gateway Capital Statutory Trust III	Delaware
Gateway Capital Statutory Trust IV	Delaware

Section 12: EX-23 (EXHIBIT 23)

Exhibit 23

Consent of Independent Registered Public Accounting Firm

The Board of Directors
Gateway Financial Holdings, Inc.

We consent to the incorporation by reference in the registration statements (Nos. 333-98027, 333-98025, 333-98021, and 333-127978) on Forms S-8 and the registration statement (No. 333-126709) on Form S-3 of Gateway Financial Holdings, Inc. of our reports dated March 10, 2008, with respect to the consolidated financial statements of Gateway Financial Holdings, Inc. and Subsidiary, and the effectiveness of internal control over financial reporting, which reports appear in the December 31, 2007 annual report on Form 10-K of Gateway Financial Holdings, Inc.

Greenville, North Carolina
March 10, 2008

Section 13: EX-31.1 (EXHIBIT 31.1)

Exhibit 31.1

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER

Pursuant to Rule 13a-14(d)/15d-14(d)

I, D. Ben Berry, certify that:

(1) I have reviewed this annual report on Form 10-K of Gateway Financial Holdings, Inc., a North Carolina corporation (the "registrant");

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

(4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

(5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 14, 2008

By: */s/ D. Ben Berry*
D. Ben Berry
President and Chief Executive Officer

Section 14: EX-31.2 (EXHIBIT 31.2)

Exhibit 31.2

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER

Pursuant to Rule 13a-14(d)/15d-14(d)

I, Theodore L. Salter, certify that:

(1) I have reviewed this annual report on Form 10-K of Gateway Financial Holdings, Inc., a North Carolina corporation (the "registrant");

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

(4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

(5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 14, 2008

By: */s/ Theodore L. Salter*
Theodore L. Salter
Senior Executive Vice President and Chief Financial Officer

Section 15: EX-32 (EXHIBIT 32)

Exhibit 32

Section 1350 Certifications

Each of the undersigned hereby certifies that, to his knowledge, **(i)** the Form 10-K filed by Gateway Financial Holdings, Inc. (the "Issuer") for the year ended December 31, 2007, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and **(ii)** the information contained in that report fairly presents, in all material respects, the financial condition and results of operations of the Issuer on the dates and for the periods presented therein.

GATEWAY FINANCIAL HOLDINGS, INC.

Date: March 14, 2008

By: */s/ D. Ben Berry*
D. Ben Berry
President and Chief Executive Officer

Date: March 14, 2008

By: */s/ Theodore L. Salter*
Theodore L. Salter
Senior Executive Vice President and Chief Financial Officer