RITCHIE BROS AUCTIONEERS INC
Form 6-K
March 15, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

Form 6-K
REPORT OF FOREIGN PRIVATE ISSUER
PURSUANT TO RULE 13A-16 OR 15D-16 UNDER
THE SECURITIES EXCHANGE ACT OF 1934
Date of Report: March 14, 2007

Commission File Number: 001-13425
Ritchie Bros. Auctioneers Incorporated
6500 River Road
Richmond, BC, Canada
V6X 4G5
(604) 273 7564
(Address of principal executive offices)

indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F
Form 20-F o Form 40-F þ
indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1): o
indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7): o
indicate by check mark whether by furnishing information contained in this Form, the registrant is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934
Yes o No þ
If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-_____

This Form 6-K incorporates the Notice of Annual and Special Meeting of Shareholders, Information Circular and Form of Proxy distributed to the Company s shareholders of record as of March 2, 2007. The Information Circular was provided to shareholders in connection with the Company s annual meeting to be held on April 13, 2007.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Ritchie Bros. Auctioneers Incorporated
(Registrant)

Date: March 14, 2007

By: */s/ Robert S. Armstrong*
Robert S. Armstrong,
Corporate Secretary

RITCHIE BROS. AUCTIONEERS INCORPORATED
NOTICE OF ANNUAL AND SPECIAL MEETING OF SHAREHOLDERS

TO THE SHAREHOLDERS:

NOTICE IS HEREBY GIVEN that an Annual and Special Meeting (the Meeting) of the shareholders of RITCHIE BROS. AUCTIONEERS INCORPORATED (the Company) will be held at the Vancouver Airport Marriott Hotel, 7571 Westminster Highway, Richmond, B.C., Canada, V6X 1A3, on Friday, April 13, 2007 at 11:00 a.m. (Vancouver time), for the following purposes:

(1) to receive the financial statements of the Company for the financial year ended December 31, 2006 and the report of the Auditors thereon;

(2) to elect the directors of the Company to hold office until their successors are elected at the next annual meeting of the Company;

(3) to appoint the Auditors of the Company to hold office until the next annual meeting of the Company and to authorize the directors to fix the remuneration to be paid to the Auditors;

(4) to consider and, if deemed advisable, to pass an ordinary resolution approving amendments to the Company s Stock Option Plan, the full text of which resolution is set out in Schedule A in the accompanying Information Circular;

(5) to consider and, if deemed advisable, to pass an ordinary resolution approving the adoption of a Shareholder Rights Plan in accordance with a Shareholder Rights Plan Agreement dated as of February 22, 2007 between the Company and Computershare Investor Services Inc., the full text of which resolution is set out in Schedule B in the accompanying Information Circular; and

(6) to transact such other business as may properly be brought before the Meeting.

Further information regarding the matters to be considered at the Meeting is set out in the accompanying Information Circular.

The directors of the Company have fixed the close of business on March 2, 2007 as the record date for determining shareholders entitled to receive notice of and to vote at the Meeting. Only registered shareholders of the Company as of March 2, 2007 will be entitled to vote, in person or by proxy, at the Meeting.

Shareholders are requested to date, sign and return the accompanying form of proxy for use at the Meeting whether or not they are able to attend personally. To be effective, forms of proxy must be received by Computershare Trust Company of Canada, Attention Proxy Department, 100 University Avenue, 9th Floor, Toronto, Ontario, M5J 2Y1, no later than 48 hours (excluding Saturdays, Sundays and holidays) before the time of the Meeting or any adjournment thereof.

All non-registered shareholders who receive these materials through a broker or other intermediary should complete and return the materials in accordance with the instructions provided to them by such broker or intermediary.

DATED at Vancouver, British Columbia, as of this 14th day of March, 2007.

By Order of the Board of Directors

Robert S. Armstrong
Corporate Secretary

RITCHIE BROS. AUCTIONEERS INCORPORATED
ANNUAL AND SPECIAL MEETING OF SHAREHOLDERS
INFORMATION CIRCULAR

Unless otherwise provided, the information herein is given as of February 21, 2007.

Solicitation of Proxies

This Information Circular is being furnished to the shareholders of the Company in connection with the solicitation of proxies for use at the Annual and Special Meeting to be held on April 13, 2007 (the Meeting) by management of the Company. The solicitation will be primarily by mail, however, proxies may also be solicited personally or by telephone by the directors, officers or employees of the Company. The Company may also pay brokers or other persons holding common shares of the Company (the Common Shares) in their own names or in the names of nominees for their reasonable expenses of sending proxies and proxy materials to beneficial shareholders for the purposes of obtaining their proxies. The costs of this solicitation are being borne by the Company.

PARTICULARS OF MATTERS TO BE ACTED UPON AT THE MEETING

Number of Directors and Election of Directors

Under the Articles of Amalgamation of the Company, the number of directors of the Company is set at a minimum of three (3) and a maximum of ten (10) and the directors are authorized to determine the actual number of directors within that range to be elected from time to time. The Company currently has seven (7) directors. Each director of the Company is elected annually and holds office until the next Annual Meeting of the Company unless he or she sooner ceases to hold office. The Board of the Company has determined that the number of directors to be elected at the Meeting shall be seven (7). The Company intends to nominate each of the persons listed below for election as a director of the Company. The persons proposed for nomination are, in the opinion of the Board and management, well qualified to act as directors for the ensuing year. The persons named in the enclosed form of proxy intend to vote for the election of such nominees.

Name and Municipality of Residence	Position with the Company	Principal Occupation or Employment (1)	Previous Service as a Director	Number of Common Shares Beneficially Owned, Controlled or Directed(1)(2)
Charles Edward Croft Vancouver, B.C., Canada	Chairman of the Board and a Director (3); Chair of Compensation Committee Member of Nominating and Corporate Governance Committee;	President and Director, Falcon Pacific Financial Corp. (private investment company) and its subsidiaries (4)	Director since June 17, 1998	17,200(5)
Peter James Blake Vancouver, B.C., Canada	Chief Executive Officer and a Director	Chief Executive Officer of the Company	Director since December 12, 1997	67,281
Clifford Russell Cmolik Surrey, B.C., Canada	Director; Member of Compensation Committee	Businessman (6)	Director since December 12, 1997	2,685,822(7)

Eric Patel Vancouver, B.C., Canada	Director; Chair of Nominating and Corporate Governance Committee Member of Audit Committee	Business Consultant	Director since April 14, 2004	2,850
Beverley Anne Briscoe Vancouver, B.C., Canada	Director; Chair of Audit Committee [8] Member of Nominating and Corporate Governance Committee	Owner and Principal, Briscoe Management Ltd. [9]	Director since October 29, 2004	2,500

Name and Municipality of Residence	Position with the Company	Principal Occupation or Employment [1]	Previous Service as a Director	Number of Common Shares Beneficially Owned, Controlled or Directed [1][2]
Robert Waugh Murdoch Salt Spring Island, B.C., Canada	Director; Member of Compensation Committee	Businessman [10]	Director since February 20, 2006	990
Edward Baltazar Pitoniak West Vancouver, B.C., Canada	Director; Member of Audit Committee [11]	President & Chief Executive Officer and Trustee, Canadian Hotel Income Properties Real Estate Investment Trust [12]	Director since July 28, 2006	65

(1) This information has been provided by the respective nominee as of February 21, 2007.

(2) The number of Common Shares held includes Common Shares beneficially owned, directly or indirectly (other than stock options), or over which control or direction is exercised by the proposed nominee. See the table below for disclosure of

stock option information.

(3) Mr. Croft became Chairman of the Board of Directors effective November 30, 2006 upon the retirement from that position and the Board of David E. Ritchie, who had been Chairman and a Director since December 12, 1997. Mr. Croft previously held the position of Vice-Chairman of the Board. Mr. Ritchie was appointed to the honourary position of Chairman Emeritus upon his retirement.

(4) Mr. Croft was a director of a Canadian private company that entered into a Plan of Arrangement under the Companies Creditors Arrangement Act in 2004, immediately following his resignation as a director thereof. The company subsequently

emerged from protection in 2004.

(5) 15,000 of such shares are held by Falcon Pacific Financial Corp., a company controlled by Mr. Croft.

(6) Mr. Cmolik was the President and Chief Operating Officer of the Company until his retirement in July 2002. The Board has determined that Mr. Cmolik is an independent director.

(7) 1,960,568 of such shares are held by C.R.C. Auctions Ltd. and 720,436 of such shares are held by Cmolik Enterprises Ltd., both of which are controlled by Mr. Cmolik. Mr. Cmolik holds the remaining 4,818 shares personally.

(8) Ms. Briscoe was appointed Chair of the Audit Committee effective April 13, 2006, and replaced G.

Edward Moul, the former Chair who retired from the Board effective April 13, 2006.

(9) Ms. Briscoe is also a director of Goldcorp Inc., Spectra Energy Income Fund, BC Railway Company, and Westminster Savings Credit Union. In addition, Ms. Briscoe is Chair of the B.C. Government s Industry Training Authority.

(10) Mr. Murdoch is a member of the international advisory board of Lafarge S.A., as well as a director of Lallemand Inc. and Timberwest Forest Corp.

(11) Mr. Pitoniak was appointed to the Company s Board effective July 28, 2006. Mr. Pitoniak was also appointed to the Audit Committee effective July 28, 2006,

and replaced Mr. Cmolik on that committee. Mr. Cmolik had been appointed to the Audit Committee effective April 13, 2006, upon the retirement of Mr. Moul (see note 8 above).

(12) Mr. Pitoniak is the President & Chief Executive Officer and a Trustee of Canadian Hotel Income Properties Real Estate Investment Trust, a public company, a position he has held since 2004. Prior to that he was a Senior Vice-President with Intrawest Corporation (1996 to 2004) and held senior editorial and advertising positions at SKI Magazine, part of Times Mirror Magazines. Mr. Pitoniak holds a Bachelor of Arts degree from Amherst College.

In addition to the information presented above regarding Common Shares beneficially owned, controlled or directed, the directors of the Company held the stock options set out in the following table as of the date of this Information Circular. All of the options granted to and held by non-employee directors vested at the grant date and have an expiry date ten years from the date of grant. The options granted to Mr. Blake, the CEO of the Company, vested one year from the grant date and have the expiry date of ten years, subject to early termination, applicable to officer and employee options, as set out in the relevant option agreement.

Nominee	**Grant Date**	**Expiry Date**	**Number of Options Granted**	**Exercise Price (U.S.$)**	**Total Exercised**	**Total Unexercised**
Peter Blake	Jan. 24, 2006	Jan. 24, 2016	24,000	$44.09		24,000
	Jan. 25, 2005	Jan. 25, 2015	20,800	$32.41		20,800
	Feb. 13, 2004	Feb. 13, 2014	22,400	$26.46		22,400
	Jan. 30, 2003	Jan. 30, 2013	30,000	$15.53	15,400	14,600
			97,200		15,400	81,800
Russell Cmolik	Feb. 13, 2004	Feb. 13, 2014	8,000	$26.46		8,000
	Jan. 30, 2003	Jan. 30, 2013	8,000	$15.53		8,000
			16,000			16,000
Charles Croft	Feb. 13, 2004	Feb. 13, 2014	8,000	$26.46		8,000
	Jan. 30, 2003	Jan. 30, 2013	8,000	$15.53		8,000
	Feb. 11, 2002	Feb. 11, 2012	6,000	$13.05		6,000
	Jan. 31, 2001	Jan. 31, 2011	6,000	$11.68		6,000
	Feb. 1, 2000	Feb. 1, 2010	6,000	$13.35		6,000
	Feb. 21, 1999	Feb. 21, 2009	7,000	$13.44		7,000
			41,000			41,000

The Company is not aware that any of the above nominees will be unable or unwilling to serve as a director of the Company; however, should the Company become aware of such an occurrence before the election of directors takes place at the Meeting, if one of the persons named in the enclosed form of proxy is appointed as proxyholder, it is intended that the discretionary power granted under such proxy will be used to vote for any substitute nominee or nominees whom the Board, in its discretion, may select.

Charles E. Croft served as the Lead Director of the Board from the date of Company s Annual Meeting in 2006 until his appointment to the position of Chairman effective November 30, 2006. Because Mr. Croft is an independent director, the Company s Board has not appointed another Lead Director. However, any shareholder wishing to contact Mr. Croft may do so by phoning 604-233-6153 or by sending an email to LeadDirector@rbauction.com.

Additional disclosure relating to the Company s audit committee as required under Multilateral Instrument 52-110 is contained in the Company s Annual Information Form under the heading Audit Committee Information . The Annual Information Form of the Company has been filed on SEDAR and is available on their website at www.sedar.com. A copy of the Company s Annual Information Form may also be obtained by making a request to the Corporate Secretary of the Company.

Board and Committee Attendance

The following tables present information about Board of Directors and Committee meetings and attendance by directors at such meetings for the year ended December 31, 2006. The overall 2006 attendance record by directors at Board and Committee meetings was 92%.

Board and Committee Meetings Held

	Number of Meetings
Board of Directors	10
Audit Committee	13
Compensation Committee	2
Nominating and Corporate Governance Committee	5

Summary of Attendance of Directors

Director	**Board Meetings**	**Committee Meetings**
Charles Croft	10 of 10	7 of 7
Peter Blake	10 of 10	N/A
C. Russell Cmolik	9 of 10	6 of 7
Eric Patel	10 of 10	18 of 18
Beverley Briscoe	10 of 10	18 of 18
Robert Murdoch (1)	6 of 8	2 of 2
Edward Pitoniak (2)	4 of 5	5 of 6
David Ritchie (3)	5 of 10	N/A

(1) Mr. Murdoch was appointed to the Board on April 13, 2006.

(2) Mr. Pitoniak was appointed to the Board on July 28, 2006.

(3) Mr. Ritchie retired from the Board effective November 30, 2006.

Compensation of Directors

In addition to the reimbursement of reasonable travel and lodging expenses, non-employee directors of the Company received the following compensation in 2006:

Description of Fee	**Amount of Fee**
Annual fee for Board Chairman	U.S.$100,000(1)
Annual fee for Board Membership	U.S.$ 60,000(1)
Annual additional fee for Board Vice-Chairman	U.S.$ 50,000
Annual fee for Committee chairmanship (excluding Audit Committee)	U.S.$ 10,000
Annual fee for Audit Committee chairmanship	U.S.$ 15,000
Meeting fee (per minuted meeting in excess of two hours)	U.S.$ 1,000

(1) Each director is required to use U.S.$25,000 of the annual fee to purchase Common Shares through the NYSE or the TSX in compliance with the Company s Policy Regarding Securities Trades by Personnel.

The total fees paid by the Company to the Board in 2006 were U.S.$619,714. Employee directors do not receive additional compensation for their participation in Board or committee activities. Compensation by director for the year ended December 31, 2006 was as follows (all amounts in U.S. dollars):

Director	Board Fees	Committee Fees	Meeting Fees
Charles Croft	$ 110,000	$ 10,000	$ 15,000
Peter Blake	Nil	Nil	Nil
C. Russell Cmolik	60,000	Nil	13,000
Eric Patel	60,000	10,000	18,000
Beverley Briscoe	60,000	10,714	16,000
Robert Murdoch	51,500	Nil	6,000
Edward Pitoniak	30,000	Nil	7,000
David Ritchie	137,500	Nil	5,000
Total	**$ 509,000**	**$ 30,714**	**$ 80,000**

At their meeting on February 20, 2007, the Board approved certain revisions to the compensation plan for directors for 2007. The annual fee for the Board Chairman will be increased to U.S.$150,000 per year, retroactive to November 30, 2006. In addition, directors who travel more than four hours to attend a board or committee meeting will receive an additional U.S.$1,000.

There were no other arrangements under which non-employee directors were compensated during 2006. No non-employee directors earned any compensation during 2006 for consultancy or other services provided to the Company. No options were granted to non-employee directors in 2006.

Appointment of Auditors

The Company proposes that KPMG LLP, Chartered Accountants of Vancouver, British Columbia, be appointed as Auditors of the Company for the year ending December 31, 2007 and that the Audit Committee be authorized to fix their remuneration. KPMG LLP has been the Auditors of the Company and its predecessors since 1974. The Audit Committee is satisfied that KPMG LLP meets the relevant independence requirements and is free from conflicts of interest that could impair their objectivity in conducting the Company s audit. The resolution appointing auditors must be passed by a majority of the votes cast by the shareholders who vote in respect of that resolution.

In addition to retaining KPMG LLP to audit the consolidated financial statements of the Company and its subsidiaries for the year ended December 31, 2006, the Company retained KPMG LLP to provide various non-audit services in 2006. The Audit Committee is required to pre-approve all non-audit related services performed by KPMG LLP. The aggregate fees billed for professional services by KPMG LLP and its affiliates during fiscal 2006 and 2005 were as follows:

	Fiscal 2006	Fiscal 2005
Audit Fees	$ 1,143,000	$ 627,000
Audit-Related Fees	248,000	105,000
Tax Fees	575,000	745,000
All Other Fees		
Total Fees	$ 1,966,000	$ 1,477,000

The nature of each category of fees is as follows:

Audit Fees:

Audit fees were paid for professional services rendered by the auditors for the audit and interim reviews of the Company s consolidated financial statements or services provided in connection with statutory and regulatory filings or engagements.

Audit-Related Fees:

Audit-related fees were paid for assurance and related services that are reasonably related to the performance of the audit or review of the Company s financial statements and are not reported under the Audit Fees item above.

Tax Fees:

Tax fees were paid for tax compliance, tax advice and tax planning professional services. These services consisted of: tax compliance including the review of original and amended tax returns; assistance with questions regarding tax audits; assistance in completing routine tax schedules and calculations; and tax planning and advisory services relating to common forms of domestic and international taxation (i.e., income tax, capital tax, Goods and Services Tax and Value Added Tax).

The Audit Committee is responsible for the appointment, compensation and oversight of the work of the Company s independent auditor and is required to pre-approve all non-audit related services performed by KPMG LLP. Accordingly, the Audit Committee has adopted a pre-approval policy. The policy outlines the procedures and the conditions pursuant to which permissible services proposed to be performed by KPMG LLP are pre-approved, provides a general pre-approval for certain permissible services and outlines a list of prohibited services.

Amendments to the Stock Option Plan

At the Meeting, shareholders of the Company will be asked to consider and, if deemed advisable, to pass, with or without variation, an ordinary resolution approving amendments to the Company s Stock Option Plan.

The Company has a stock option plan (the Plan), adopted as of July 30, 1997 and approved by the then shareholders of the Company under which the Compensation Committee is authorized, at its discretion, to grant options to purchase Common Shares to directors, officers, employees, and consultants of the Company or its subsidiaries. The Plan has a term of 10 years from the date of adoption. The purpose of the Plan is to promote the interests of the Company by providing eligible persons with additional incentive, encouraging stock ownership and increasing the proprietary interest of eligible persons in the success of the Company and assisting the Company in attracting, retaining and motivating its directors, officers and employees. The Plan was amended in 2006 by the Compensation Committee pursuant to the power under the Plan to allow for on-line exercise of options. For a description of the current Plan, see Securities Authorized for Issuance Under Equity Compensation Plans on page 19.

The Plan specifies that the maximum number of Common Shares which may be reserved for issuance under the Plan may not exceed 3,000,000 Common Shares (being 9% of total issued and outstanding shares) (taking into account the two-for-one stock split of the Common Shares that occurred on May 4, 2004), of which 1,286,468 Common Shares have been issued, 793,648 Common Shares are reserved for issuance upon exercise of options that have been granted (2% of total issued and outstanding shares) and 919,884 Common Shares (3% of total issued and outstanding shares) remain available for future options to be granted.

The Company wishes to amend and restate the Plan (the Amended Plan) in order to extend the term of the Plan, to ensure that the Plan is up-to-date and continues to serve its original purpose and to ensure that it conforms with regulatory requirements. The main amendments reflected in the Amended Plan include, without limitation, the following:

(a) the number of Common Shares that may be issued from and after the effective date of the Amended Plan pursuant to options granted under the Amended Plan has been increased to 3,400,000. This new maximum number will cover Common Shares to be issued upon exercise of all existing issued and outstanding options as well as all future options to be granted under the Amended Plan;

(b) the term of an option which expires during a Black Out Period will be automatically extended and will expire on the fifth business day following the end of such restricted period;

(c) the maximum percentages of Common Shares (in relation to the number of outstanding and issued Common Shares) available to insiders are outlined;

(d) a cap is placed on the percentage of Common Shares issued and reserved for issuance to non-employee directors of the Company upon exercise of options;

(e) the CEO is authorized to grant up to a certain number of options to employees other than to directors and officers;

(f) the provisions dealing with the manner of adjustment of options in the event of certain corporate actions (such as a subdivision or consolidation of Common Shares, a distribution to shareholders, a fundamental change such as a reorganization, amalgamation or arrangement or a proposed change of control) have been amended and updated; and

(g) the provisions dealing with amendments have been revised to describe those amendments that may be made by the Compensation Committee and those that may only be made with shareholder approval.

At a meeting held on February 20, 2007, the Board unanimously approved the various amendments (the Plan Amendments) to the Plan. These changes are described in greater detail below.

Pursuant to the Plan Amendments it is proposed that the maximum aggregate number of Common Shares issuable under the Amended Plan from and after the date of the Meeting will be 3,400,000 Common Shares, representing approximately 10% of the currently issued and outstanding Common Shares on a fully diluted basis (or 10% on a non-diluted basis), including the 793,648 Common Shares reserved for issuance pursuant to options outstanding and unexercised as at February 21, 2007. As a result, 2,606,352 Common Shares will be available for future grants after giving effect to the Plan Amendments. This reflects a partial replenishment of the Common Shares available for issuance under the Plan, with the new maximum number (covering issuances upon the exercise of existing outstanding options and future options to be granted under the Amended Plan) being fixed at 3,400,000 Common Shares.

Pursuant to the Amended Plan, the Company will continue to grant options to purchase Common Shares to selected employees. The Board considers that stock options are an important element of the Company s compensation structure. The Board believes that the increased maximum number is desirable in order to permit the Company to continue to accomplish the purposes of the Amended Plan and to provide for future grants of options. Options may be granted by the Compensation Committee; however, under the Amended Plan, the CEO is also authorized to grant a limited number of options pursuant to the delegation of option-granting power under a Company policy. See Equity-based Compensation Awards Grant Policy on page 19.

Under a recently adopted policy, the Company has determined not to grant equity awards to non-employee directors until determined otherwise, and under the Amended Plan, the maximum number of Common Shares issued and reserved for issuance to non-employee directors of the Company upon exercise of options must not exceed 1% of the issued and outstanding Common Shares. The number of Common Shares issuable to Insiders under the Amended Plan, when combined with the Company s other security-based compensation arrangements, within any one-year period cannot exceed 10% of the issued and outstanding Common Shares and the number of Common Shares issuable to Insiders at any time cannot exceed 10% of the issued and outstanding Common Shares. This amendment brings the Amended Plan in line with TSX requirements with respect to eligibility of insiders to vote their securities in respect of security holder approval required for security based compensation arrangements. In addition, the definition of Insider has been revised in the Amended Plan to reflect updates in securities legislation.

The Amended Plan has also been revised to take into account the Company s policy with respect to making grants only during specific trading windows. If the expiry date of an option falls during a Black Out Period , the expiry date will be extended to the fifth business day following the expiry of such period.

Options will vest in accordance with the provisions of the Option Agreement in respect of the specific option. The exercise price will generally be determined by reference to the closing market price of the Common Shares on the NYSE on the date of grant.

Under the Amended Plan, each option will expire on the date determined by the Compensation Committee and specified in the applicable Option Agreement, as provided in the Amended Plan. Generally, the form of Option Agreement to be used in conjunction with the Amended Plan provides that an optionee may exercise his or her options prior to the date stated in the Option Agreement (generally ten years from the date of grant) subject to the following:

(a) in the event that the optionee retires or resigns his or her office of employment (unless terminated as set out below under paragraph (c)) or the optionee s contract as consultant is terminated at the end of its term, the option will expire 30 days after the Termination Date (as defined in the form of Option Agreement to be used in conjunction with the Amended Plan);

(b) in the event that the optionee s employment with the Company is terminated without cause or where a consultant s contract is terminated other than due to expiry of its term or for cause (unless terminated as set out below under paragraph (c)), the option will expire 30 days after the Termination Date;

(c) in the event that the optionee ceases to be an Eligible Person under the Amended Plan as a result of his or her termination for cause or as a result of the termination of his or her contract as a consultant for cause, the option will expire immediately; and

(d) in the event of the death of the optionee, the option will expire on the date which is 180 days after the date of death of the optionee.

The extension of an early expiry date coinciding with a Black Out Period applies in the event of early termination of the optionee except in the event of a termination for cause under paragraph (c) above.

Options granted under the Amended Plan are not transferable or assignable and may be exercised only by the optionee or, in the event of the death of the optionee or the appointment of a committee or duly appointed attorney of the optionee or of the estate of the optionee on the grounds that the optionee is incapable, by reason of physical or mental infirmity, of managing its affairs, by the optionee s legal representative or such committee or attorney, as the case may be.

The Amended Plan includes customary anti-dilution provisions (for example, in the event of a subdivision or consolidation of Common Shares) for the benefit of optionees. In addition, if there is a change of control (which includes an acquisition of more than 50% of the Company s then issued and outstanding shares, an amalgamation, arrangement or business combination or a sale of all or substantially all of the property of the Company), the Compensation Committee may, in its sole discretion, determine the manner in which all unexercised options granted under the Amended Plan will be treated. For example, the Compensation Committee may elect to accelerate the vesting of any or all outstanding options immediately prior to completion of a change of control, subject to applicable regulatory approval, and may determine that outstanding options are to be purchased by the Company or the new control person for a price determined based on the consideration paid in the applicable transaction.

The Compensation Committee will have the rights to suspend, amend or terminate the Amended Plan without approval of optionees or shareholders (provided that no such suspension, amendment or termination will materially prejudice the rights of any optionee under any previously granted option without the consent or deemed consent of such optionee), including, without limitation:

(a) to avoid any additional tax on optionees under Section 409A of the United States Internal Revenue Code or other applicable tax legislation;

(b) changing the eligibility for and limitations on participation in the Amended Plan (other than participation by non-employee directors in the Amended Plan);

(c) making any addition to, deletion from or alteration of the provisions of the Amended Plan that are necessary to comply with applicable law or the requirements of any regulatory authority or stock exchange;

(d)

making any amendment of a typographical, grammatical, administrative or clerical nature, or clarification correcting or rectifying any ambiguity, defective provision, error or omission in the Amended Plan; and

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(e) changing the provisions relating to the administration of the Amended Plan or the manner of exercise of the options, including:
   i. changing or adding any form of financial assistance provided by the Company to the participants that would facilitate purchase of Common Shares under the Amended Plan; and

   ii. adding provisions relating to a cashless exercise (which will provide for a full deduction of the underlying Common Shares from the maximum number reserved under the Amended Plan for issuance).

Notwithstanding the foregoing powers of amendment accorded the Compensation Committee, none of the following amendments to the Amended Plan may be made without shareholder approval:

(a) any increase in the maximum number of Common Shares that may be issued pursuant to the exercise of options granted under the Amended Plan;

(b) any reduction in exercise price or cancellation and reissue of options;

(c) any amendment that extends the term of an option beyond the original expiry date;

(d) if at any time, the Amended Plan is further amended to exclude participation by non-employee directors, any amendment to Eligible Participants that may permit the introduction or reintroduction of non-employee directors on a discretionary basis;

(e) any amendment that increases limits previously imposed on non-employee director participation;

(f) any amendment which would permit equity based awards granted under the Amended Plan to be transferable or assignable other than for normal estate settlement purposes;

(g) any amendment to increase the maximum limit of the number of securities that may be:
   (i) issued to insiders of the Company within any one year period; or

   (ii) issuable to insiders of the Company at any time;

under the Amended Plan, or when combined with all of the Company s other security based compensation arrangements, which could exceed 10% of the total issued and outstanding Common Shares of the Company, respectively;

(h) adding provisions relating to a cashless exercise (other than a surrender of options for cash) which does not provide for a full deduction of the underlying Common Shares from the maximum number reserved under the Amended Plan, for issuance; and

(i) any amendment to the amending provisions of the Amended Plan.

Section 422 of the United States Internal Revenue Code, as amended, and the regulations thereunder, require that in order for options to qualify for the United States income tax treatment applicable to incentive stock options , they must be awarded under a plan approved by the shareholders that specifically includes the maximum aggregate number of shares that may be issued under incentive stock options. By including the fixed maximum number of 3,400,000, the Company has complied with this requirement. The Amended Plan also contains other provisions that allow for the grant of incentive stock options and nonqualified stock options as defined under the U.S. Internal Revenue Code.

The Amended Plan also includes other housekeeping and clerical amendments, such as the updating of statutory references and insertion of certain defined terms, for consistency of language and correctness.

To date, no options have been granted under the Amended Plan and no options will be granted under the Amended Plan prior to approval of the Amended Plan by shareholders.

The Plan Amendments are reflected in the Amended Plan. A copy of the Amended Plan will be tabled at the Meeting, and will be provided to any shareholder upon request from the Corporate Secretary of the Company at 6500 River Road, Richmond, British Columbia, V6X 4G5, telephone (604) 273-7564, prior to the day of the Meeting.

Under the requirements of the Toronto Stock Exchange, the Plan Amendments and the Amended Plan must be approved by the shareholders of the Company. Consequently, at the Meeting shareholders will be asked to consider and, if deemed appropriate, pass an ordinary resolution ratifying and approving the Plan Amendments and approving the Amended Plan. The text of the proposed resolution is set out in Schedule A . This resolution must be passed by a simple majority of the votes cast by shareholders entitled to vote in person or by proxy at the Meeting. It is intended that all proxies received by the Company will be voted in favour of the Plan Amendments and the Amended Plan, unless a proxy contains express instructions to vote against the Plan Amendments and the Amended Plan. The Board of the Company recommends that shareholders vote in favour of amending the Plan.

Adoption of Shareholder Rights Plan

Effective February 22, 2007, the Board of Directors of the Company adopted a shareholder rights plan agreement, with Computershare Investor Services Inc. as rights agent (the Rights Plan). The Rights Plan has the following main objectives:

- to provide the Board time to consider value-enhancing alternatives to a take-over bid and to allow competing bids to emerge;
- to ensure that shareholders of the Company are provided equal treatment under a take-over bid; and
- to give adequate time for shareholders to properly assess a take-over bid without undue pressure.

At the Meeting, shareholders will be asked to consider, and if thought fit, to pass an ordinary resolution to approve the adoption of the Rights Plan, a copy of which is available upon request from the Corporate Secretary of the Company at 6500 River Road, Richmond, British Columbia, V6X 4G5, telephone (604) 273-7564, or from the Company s public disclosure documents found on SEDAR at *www.sedar.com* or on the U.S. Securities and Exchange Commission (SEC) EDGAR database at *www.sec.gov*.

The Board has considered the terms of a number of recently adopted or amended shareholder rights plans and the experience of other Canadian public companies in the context of an actual take-over bid where a shareholder rights agreement was in place, and has determined that it is in the best interests of the Company to adopt the Rights Plan. The Rights Plan is designed to maximize shareholder value and protect shareholders interests in the event of an acquisition that may result in a change of control. The Rights Plan is not intended to prevent take-over bids that treat shareholders fairly, and the Rights Plan has not been adopted in response to any proposal to acquire control of the Company.

Summary of the Principal Terms of the Rights Plan

The following is a summary of key terms of the Rights Plan. **This summary is qualified in its entirety by reference to the full text of the Rights Plan, which is available upon request from the Corporate Secretary of the Company as indicated above or from the Company s public disclosure documents found on SEDAR at *www.sedar.com* or on the SEC s EDGAR database at *www.sec.gov*. Capitalized terms not otherwise defined herein shall have the meanings ascribed thereto in the Rights Plan.**

Issue of Rights

On February 22, 2007, the Company issued one right (a Right) in respect of each Common Share outstanding at the close of business on that date (the Record Time). The Company will issue Rights in respect of each Common Share issued after the Record Time but prior to the earliest of the Separation Time (as defined below) and the redemption of the Rights pursuant to the Rights Plan or termination of the Rights Plan as described below.

Rights Certificates, Trading and Transferability

Before the Separation Time, the Rights will be evidenced by the certificates representing Common Shares and will not be transferable separate from the Common Shares. Accordingly, the surrender for transfer of any certificate representing Common Shares will also constitute the surrender for transfer of the Rights associated with such Common Shares. From and after the Separation Time, the Rights will be evidenced by separate Rights certificates.

Acquiring Person

An Acquiring Person is a person that Beneficially Owns 20% or more of the outstanding Common Shares. An Acquiring Person does not, however, include the Company or any Subsidiary of the Company, or any person that becomes the Beneficial Owner of 20% or more of the Common Shares as a result of certain exempt transactions. These exempt transactions include where any person becomes the Beneficial Owner of 20% or more of the Common Shares as a result of, among other things: (i) specified acquisitions of securities of the Company, (ii) acquisitions pursuant to a Permitted Bid or Competing Permitted Bid (as described below), (iii) specified distributions of securities of the Company, and (iv) certain other specified exempt acquisitions. An Acquiring Person also does not include any Person that owned 20% or more of the outstanding Common Shares at the Record Time unless that person increases its percentage interest in the Common Shares other than pursuant to one of the previously mentioned transactions.

Separation Time

Rights are not exercisable before the Separation Time. Separation Time means the close of business on the tenth trading day after the earliest of:

(a) the first date of public announcement that a person has become an Acquiring Person, as defined below (the Stock Acquisition Date);

(b) the date of the commencement of, or first public announcement of, the intent of any person (other than the Company or any of its subsidiaries) to commence a Take-over Bid, as defined in the Rights Plan (other than a Permitted Bid or a Competing Permitted Bid, as defined below), which is generally an offer for outstanding Common Shares that could result in the offeror becoming the beneficial owner of 20% or more of the Company s outstanding Common Shares; and

(c) the date on which a Permitted Bid or Competing Permitted Bid ceases to be such;

or such later time as may be determined by the Board, in good faith, provided that if any bid referred to above expires or is cancelled, terminated or otherwise withdrawn prior to the Separation Time, such offer shall be deemed never to have been made.

Exercising Rights at such time until the tenth trading day after the first public announcement of the occurrence of a Flip-in Event will entitle the holder to purchase one Common Share at the exercise price (the Exercise Price), which shall equal three times the market price per Common Share determined at the Separation Time, subject to subsequent adjustment in accordance with the Rights Plan.

Exercise of Rights

After the close of business on the tenth trading day after the first public announcement of the occurrence of a Flip-in Event , which is a transaction or event pursuant to which any person becomes an Acquiring Person, each Right will entitle the holder thereof to receive upon exercise of the Right that number of Common Shares equal to twice the Exercise Price. However, any Rights beneficially held by an Acquiring Person, including its affiliates, associates and joint actors, or the transferee of any such person, will become null and void. Accordingly, such persons will be unable to transfer or exercise any Rights.

Until a Right is exercised, the holder of the Right will have no rights as a Company shareholder solely with respect to that Right.

In lieu of the issuance of fractional shares upon the issuance of any Rights, the Company will make cash payments based on the market price of such shares in amounts exceeding U.S.$10.00.

Acquisitions that require shareholder approval or for which the Board has waived application of the Rights Plan as described below, or acquisitions pursuant to a Permitted Bid or a Competing Permitted Bid are among the transactions that do not constitute Flip-in Events .

Permitted Bids

Under the Rights Plan, those bids that meet certain requirements intended to protect the interests of all shareholders are deemed to be Permitted Bids . Permitted Bids are offers to acquire Common Shares made by way of a take-over circular and where the Common Shares subject to the offer (together with shares owned by the offeror and its affiliates, associates and joint actors) constitute 20% or more of the outstanding Common Shares, and which also comply with the following conditions:

(a) the bid is made to all registered holders of Common Shares (other than Common Shares owned by the offeror);

(b) the bid provides that no Common Shares will be taken up or paid for pursuant to the bid before the close of business on the date that is not less than 60 days following the date the take-over bid circular is sent to holders of Common Shares, and that no Common Shares will be taken up or paid for unless at such date more than 50% of the outstanding Common Shares held by shareholders other than the offeror and certain related parties have been deposited pursuant to the bid and not withdrawn;

(c) the bid provides that any Common Shares may be deposited to and withdrawn from the take-over bid at any time before such Common Shares are taken up and paid for; and

(d) the bid provides that, in the event that more than 50% of the outstanding Common Shares are deposited and not withdrawn as described in clause (b) above, the offeror will make a public announcement of that fact and the bid shall remain open for an additional ten business days from the date of such announcement for the deposit and tender of additional Common Shares.

A Competing Permitted Bid is a take-over bid that is made after a Permitted Bid or other Competing Permitted Bid has been made and prior to the expiration of such prior bid, and that satisfies the definition of Permitted Bid except that Common Shares under such bid may not be taken up or paid for until a date that is no earlier than the later of: (i) the earliest date that Common Shares may be taken up and paid for under any prior Permitted Bid or other Competing Permitted Bid outstanding on the date of commencement of such bid; and (ii) 35 days after the commencement of the Competing Permitted Bid.

Protection Against Dilution

The Rights Plan contains detailed provisions regarding adjustments to the exercise price, the number and nature of the securities that may be purchased upon exercise of Rights and the number of Rights outstanding to prevent dilution in the event of certain declarations of dividends, subdivisions or consolidations of outstanding Common Shares, issuances of Common Shares (or other securities or rights) in respect of or in lieu of or in exchange for existing Common Shares or other changes in the Common Shares.

Redemption

At any time prior to the occurrence of a Flip-in Event, the Board may (subject to the prior consent of shareholders by a majority vote), at its option, elect to redeem all but not less than all of the then-outstanding Rights at a redemption price of $0.000001 per Right, subject to adjustment.

Waiver

The Board, acting in good faith, may waive application of the Rights Plan to any prospective Flip-In Event which would occur by reason of a take-over bid made by a take-over bid circular to all registered holders of Common Shares. However, if the Board waives the Rights Plan for a particular bid, it will be deemed to have waived the Rights Plan for any other take-over bid made by take-over bid circular to all registered holders of Common Shares before the expiry of the first bid. The Board may also waive the application of the Rights Plan for any Flip-In Event if it has determined that the Acquiring Person became an Acquiring Person through inadvertence, conditional upon such person reducing its beneficial ownership below 20% of the Company s outstanding Common Shares, generally within 14 days of the Board making such determination.

Amendments

Except for minor amendments to correct any clerical or typographical errors and amendments to maintain the validity of the Rights Plan as a result of a change of law or regulatory requirements, majority shareholder approval is required for amendments to the Rights Plan before the Separation Time, after which the approval of holders of Rights is required.

Term

If the Rights Plan is not adopted at the Meeting, it will automatically terminate and the Rights issued under it will become void. If the Rights Plan is adopted at the Meeting, it will expire at the termination of the Company s annual meeting in 2010 unless extended upon reconfirmation as described below. For the term of the Rights Plan to be extended, the Rights Plan must be reconfirmed by a resolution passed by a majority of the votes cast by all holders of Common Shares who vote in respect of such reconfirmation at the annual meeting of the Company held in 2010 and at every third annual general meeting of the Company thereafter.

Canadian Federal Income Tax Consequences

The following discussion generally summarizes certain Canadian federal income tax consequences of the issuance of Rights. This discussion is not intended to be, nor should it be construed to be, legal or tax advice. This summary is not exhaustive of all possible Canadian federal income tax consequences and does not anticipate any changes in law, whether by legislative, governmental or judicial action, nor does it take into account provincial, territorial or foreign income tax legislation or considerations. ***This summary is of a general nature only and holders of Common Shares should consult their own tax advisors with respect to their particular circumstances.***

The Company has not received any income for Canadian federal income tax purposes as a result of the issuance of the Rights. Generally, the value of a right, if any, to acquire additional shares of a company is not a taxable benefit to a common shareholder of the Company under the *Income Tax Act* (Canada) (the Act) and is not subject to non-resident withholding tax under the Act if identical rights are conferred on all owners of Common Shares at that time. While the Rights are conferred on all owners of Common Shares, the Rights may become void in the hands of certain shareholders upon the occurrence of certain triggering events. Whether the issuance of the Rights to shareholders of the Company will be deemed to be a taxable benefit which is required to be included in computing their income or subject to non-resident withholding tax is not therefore free of doubt, but only the amount or value of such benefit must be included in computing income. The Company considers the Rights to have had no monetary value at their date of issue. Where Rights are disposed of (other than on the exercise thereof), either separately or by virtue of the disposition of the Common Shares to which they are attached, holders thereof may be subject to tax in respect of the proceeds, if any, allocable to such Rights.

The foregoing does not address the Canadian income tax consequences of other events such as the separation of the Rights from the Common Shares, the occurrence of a Flip-in Event or the redemption of Rights. Shareholders are encouraged to consult their own tax advisors if they have questions with respect to such tax consequences and their personal circumstances.

United States Federal Income Tax Consequences

The following discussion generally summarizes certain United States federal income tax consequences of the issuance of Rights. This discussion is not intended to be, nor should it be construed to be, legal or tax advice. This summary is not exhaustive of all possible United States federal income tax consequences and does not anticipate any changes in law, whether by legislative, governmental or judicial action, nor does it take into account any state, local or foreign income tax considerations. ***This summary is of a general nature only and holders of Common Shares should consult their own tax advisors with respect to their particular circumstances.***

Because the possibility of the Rights becoming exercisable is both remote and speculative, the adoption of the Rights Plan will not give rise to the realization of gross income by any holder of Common Shares for United States federal income tax purposes. Where Rights are disposed of (other than on the exercise thereof), either separately or by virtue of the disposition of the Common Shares to which they are attached, holders thereof may be subject to tax in respect of the proceeds, if any, allocable to such Rights.

The foregoing does not address the United States federal income tax consequences of other events, such as the separation of the Rights from the Common Shares, the occurrence of a Flip-in Event or the redemption of Rights. Shareholders may recognize gross income for United States federal income tax purposes in connection with these events. Shareholders are encouraged to consult their own tax advisors if they have questions with respect to such tax consequences and their personal circumstances.

Voting of Proxies and Recommendation of Board

It is intended that all proxies received by the Company will be voted in favour of the adoption of the Rights Plan, unless a proxy contains express instructions to vote against the Rights Plan. The Rights Plan will continue in effect only if it is approved by greater than 50% of the votes cast by shareholders present in person or by proxy at the Meeting. The text of the resolution approving the Rights Plan is set forth in Schedule B hereto. If the Rights Plan is not approved by shareholders at the Meeting it will terminate and the Rights issued under it will be void.

The Board of Directors of the Company recommends that shareholders vote in favour of the resolution approving the Rights Plan.

INTEREST OF CERTAIN PERSONS IN MATTERS TO BE ACTED UPON

None of the directors or senior officers of the Company, none of the persons who have been directors or senior officers of the Company since January 1, 2006 and no associate or affiliate of any of the foregoing has any material interest, direct or indirect, by way of beneficial ownership of securities or otherwise, in any matter scheduled to be acted upon at the Meeting other than as disclosed elsewhere in this Information Circular.

INTEREST OF INFORMED PERSONS IN MATERIAL TRANSACTIONS

Other than as set out herein, no informed person (as defined under Multilateral Instrument 51-102) of the Company, any proposed director of the Company or any associate or affiliate of such persons, has had or has any material interest, direct or indirect, in any transaction since January 1, 2006 or in any proposed transaction which, in either case, has materially affected or will materially affect the Company or any of its subsidiaries.

During the 12-month period ended December 31, 2006, the Company paid approximately U.S.$0.7 million to D.E.R. Resorts Ltd. (Resorts), a company controlled by David E. Ritchie, the former Chairman of the Company s Board of Directors who retired effective November 30, 2006. The costs were incurred pursuant to agreements, approved by the Board, by which Resorts agreed to provide meeting rooms, accommodations, meals and recreational activities at its facilities on Stuart Island in British Columbia, Canada, for certain of the Company s customers and guests. The agreements set forth the fees and costs per excursion, which were based on market prices for similar types of facilities and excursions. The Company has entered into similar agreements with Resorts in the past and intends to do so in the future.

OTHER INFORMATION REGARDING THE COMPANY

EXECUTIVE COMPENSATION

Compensation

The following table provides a summary of the compensation earned during each of the last three fiscal years by the Chief Executive Officer, the Chief Financial Officer and the Company s three most highly compensated executive officers other than the Chief Executive Officer and the Chief Financial Officer (such officers are hereafter collectively called the Named Executive Officers).

Summary Compensation Table
(all amounts in U.S. dollars)

		Annual Compensation			Long-Term Compensation Awards			
					Awards		Payouts	
Name and Principal Position [1]	**Year**	**Salary ($)**	**Bonus [2] ($)**	**Other Annual Compensation ($)**	**Securities Under Options Granted (#)[4]**	**Share or Share Units Subject to Resale Restrictions (#)**	**LTIP Payouts ($)**	**All Other Compensation ($)**
David E. Ritchie [3]	2006	137,500	Nil	Nil	Nil	Nil	Nil	Nil
Chairman Emeritus	2005	150,000	Nil	17,906	37,400	Nil	Nil	Nil
	2004	400,000	330,000	18,800	Nil	Nil	Nil	Nil
Peter J. Blake [3]	2006	350,000	505,000	8,070	24,000	Nil	Nil	Nil
Chief Executive Officer	2005	280,000	487,700	6,936	20,800	Nil	Nil	Nil
	2004	213,333	360,000	6,530	22,400	Nil	Nil	Nil
Robert S. Armstrong [3]	2006	190,000	320,000	11,572	5,000	Nil	Nil	Nil
Vice-President Finance, Chief Financial	2005	175,000	335,000	11,464	3,700	Nil	Nil	Nil
Officer and Corporate Secretary	2004	145,833	260,000	14,500	4,000	Nil	Nil	Nil
Guylain Turgeon	2006	256,000	364,000	88,518	11,200	Nil	Nil	Nil
Managing Director	2005	240,750	394,000	94,138	6,400	Nil	Nil	Nil
European Operations	2004	217,500	343,000	114,475	10,000	Nil	Nil	Nil
Randall J. Wall	2006	275,000	407,000	9,420	16,000	Nil	Nil	Nil
President Canada,	2005	250,000	440,000	5,791	18,800	Nil	Nil	Nil
Europe and Middle East	2004	208,333	347,000	10,180	20,400	Nil	Nil	Nil
Robert K. Mackay	2006	275,000	407,000	11,096	16,000	Nil	Nil	Nil
President USA,	2005	240,000	450,000	11,732	18,800	Nil	Nil	Nil
Asia and Australia	2004	206,667	348,000	9,485	22,400	Nil	Nil	Nil

(1)

All Named Executive Officers are employed by wholly- owned subsidiaries of the Company.

(2) All bonuses were earned by the Named Executive Officers in the fiscal year noted but were paid subsequent to the end of the applicable year. Bonuses include additional bonus amounts paid to the Named Executive Officer in accordance with the Company s Executive Long Term Incentive Plan adopted in 2004 (see discussion below under Executive Long Term Incentive Plan). All of the Named Executive Officers, except for Mr. Ritchie, received an additional bonus award of $100,000 under the Plan during the three years presented above, which is included in the bonus amount in this table.

(3) David E. Ritchie retired from the position of Chief Executive Officer effective October 31, 2004 and from the position of Chairman of the Company s Board of Directors effective November 30, 2006. Peter J. Blake, formerly the Company s Senior Vice-President and Chief Financial Officer, was appointed Chief Executive Officer effective November 1, 2004. Robert S. Armstrong was appointed Vice-President Finance, Chief Financial Officer and Corporate Secretary effective November 1, 2004, having served previously as the Company s Vice-President Finance and Corporate Secretary.

(4) Securities under options granted have been retroactively adjusted in the

table to reflect
the two-for-one
stock split of the
Common Shares
that occurred on
May 4, 2004.

Stock Options Granted in the 2006 Financial Year

Name	Securities Under Options Granted	% of Total Options Granted to Employees in 2006 Financial Year	Exercise Price (U.S.$ per share)	Market Value of Securities Underlying Options on the Date of Grant (U.S.$ per share)	Expiration Date
David E. Ritchie	Nil	%	$	$	
Peter J. Blake	24,000	11.7%	44.09	44.09	January 24, 2016
Robert S. Armstrong	5,000	2.4%	44.09	44.09	January 24, 2016
Guylain Turgeon	11,200	5.4%	44.09	44.09	January 24, 2016
Randall J. Wall	16,000	7.8%	44.09	44.09	January 24, 2016
Robert K. Mackay	16,000	7.8%	44.09	44.09	January 24, 2016

The options granted to the Named Executive Officers during the last three financial years had the following fair values at the date of grant:

Name	Year	Securities Under Options Granted	Vesting Date	Grant Date Fair Market Value (U.S.$ per share) [1]	Aggregate Grant Date Fair Market Value (U.S.$)
David E. Ritchie	2006	Nil	N/A	$	$ Nil
	2005	37,400	January 25, 2006	6.98	261,052
	2004	Nil	N/A		Nil
Peter J. Blake	2006	24,000	January 24, 2007	9.86	236,640
	2005	20,800	January 25, 2006	6.98	145,184
	2004	22,400	February 13, 2005	5.34	119,616
Robert S. Armstrong	2006	5,000	January 24, 2007	9.86	49,300

	2005	3,700	January 25, 2006	6.98	25,826
	2004	4,000	February 13, 2005	5.34	21,360
Guylain Turgeon	2006	11,200	January 24, 2007	9.86	110,432
	2005	6,400	January 25, 2006	6.98	44,672
	2004	10,000	February 13, 2005	5.34	53,400
Randall J. Wall	2006	16,000	January 24, 2007	9.86	157,760
	2005	18,800	January 25, 2006	6.98	131,224
	2004	20,400	February 13, 2005	5.34	108,936
Robert K. Mackay	2006	16,000	January 24, 2007	9.86	157,760
	2005	18,800	January 25, 2006	6.98	131,224
	2004	22,400	February 13, 2005	5.34	119,616

(1) The grant date fair market value was determined using the Black-Scholes option pricing model with the assumptions detailed in the Company s consolidated financial statements for the year ended December 31, 2006.

Aggregate Option Exercises during 2006 Financial Year and Option Value at December 31, 2006

Name	**Securities Acquired on Exercise**	**Aggregate Value Realized (in U.S. dollars)**	**Unexercised Options at December 31, 2006 (Exercisable/Unexercisable)**	**Value of Unexercised In-The-Money Options at December 31, 2006 (in U.S. dollars) (Exercisable/Unexercisable)[1]**
David E. Ritchie	37,400	$ 955,196	Nil/Nil	Nil/Nil
Peter J. Blake	10,000	327,702	57,800/24,000	$ 1,601,115/$226,800
Robert S. Armstrong	5,500	221,756	21,600/5,000	$ 743,125/$47,250
Guylain Turgeon	8,000	365,204	37,500/11,200	$ 1,251,379/$105,840
Randall J. Wall	51,600	1,920,613	49,200/16,000	$ 1,329,826/$151,200
Robert K. Mackay	Nil	Nil	41,200/16,000	$ 1,003,836/$151,200

(1) The closing price of the Common Shares on the NYSE on December 29, 2006 (the last trading day of the year) was $53.54.

Executive Long Term Incentive Plan

The Company s executive long term incentive plan (the ELTIP) encourages senior employees and officers of the Company to use performance bonus payments to purchase and hold Common Shares through the administrator of the plan. Under the ELTIP, a participant may choose to contribute up to 100% of his performance bonus to the ELTIP and the administrator will use such contribution to purchase Common Shares in open market purchases on the NYSE during a specific period within the first trading window of the relevant fiscal year, as provided for under the Company s Policy Regarding Securities Trades by Company Personnel. The Common Shares so purchased will be held by the administrator for the participant and the participant agrees not to withdraw any Common Shares so held by the administrator unless a certain event occurs or certain conditions are satisfied (e.g. the termination, retirement or resignation of the participant). Under the ELTIP, the Company agrees to pay to participants an additional cash bonus award that equals the amount of their contributions under the ELTIP that year, subject to a maximum payment of U.S.$100,000 for the Named Executive Officers.

The ELTIP does not involve any issuance of Common Shares from the Company. The Company has also adopted share ownership guidelines, pursuant to which participants in the ELTIP are required to hold Common Shares with a value at least equal to a certain multiple of their base salary. The multiple of the base salary that is required of participants in the ELTIP depends on the participant s seniority with the Company, and ranges from one time salary to three times salary.

The Company believes that this plan, together with the Share Ownership Guidelines adopted by the Company, will facilitate the alignment of the interests of the senior employees and officers of the Company with those of the shareholders by promoting ownership of Common Shares of the Company by senior employees and officers and rewarding the creation of shareholder value over the long term.

Termination of Employment, Changes in Responsibility and Employment Contracts

The Company, through wholly-owned operating subsidiaries, has an employment agreement with each of the Named Executive Officers. All such employment agreements may be terminated with eight weeks notice (or less in certain circumstances) or payment in lieu thereof.

Composition of the Compensation Committee

The Compensation Committee of the Company consists of Messrs. Croft, Murdoch and Cmolik. Mr. Cmolik was employed by the Company in the position of President and Chief Operating Officer until his retirement in July 2002. The Board has determined that all three members of the Compensation Committee are independent directors (as defined under applicable securities legislation).

Report on Executive Compensation

The Company s policy with respect to the compensation of the Chief Executive Officer and the other Named Executive Officers and other officers of the Company is based upon the principles that total compensation must: (1) be competitive in order to help attract and retain the talent needed to lead and grow the Company s business; (2) provide a strong incentive for executives and key employees to work towards the achievement of the Company s goals; and (3) ensure that the interests of management and the Company s shareholders are aligned.

The total compensation paid to each of the Chief Executive Officer and the other Named Executive Officers of the Company consists primarily of base salary and a bonus based on the financial performance of the Company. The Named Executive Officers also receive annual option grants in accordance with the Company s stock option plan and are entitled to participate in the Company s ELTIP. The imputed value of options granted is considered in the determination of total compensation, as is the value of benefits and any other perquisites received by a particular individual. The Company does not have a predetermined relative emphasis for each of the various components of compensation.

Base salary levels for the Named Executive Officers have been determined primarily on the basis of (i) the Compensation Committee s review of the Chief Executive Officer s assessment of each Named Executive Officer s performance during the prior year and (ii) the Compensation Committee s understanding of normal and appropriate salary levels for executives with responsibilities and experience comparable to that of the Named Executive Officers of the Company. In making such determination, external sources are consulted when deemed necessary by the Compensation Committee. In February 2007, the Committee retained the services of Mercer Consulting to conduct a formal review of the Company s executive compensation arrangements. Mercer concluded that the Company s compensation programs are in line with comparable companies and result in total cash compensation to the Named Executive Officers that is 4% behind the market median for similar positions.

The Chief Executive Officer s base salary has been determined after considering the salary levels of other executives with similar responsibilities and experience and after general discussions with outside advisors, including Mercer Consulting. The Chief Executive Officer s base salary was compared to salary levels of comparable executives at a variety of companies, with particular emphasis on industrial equipment manufacturers and distributors. The Company has not had pre-established factors and criteria upon which the Chief Executive Officer s total compensation is based. In light of the fact that a new Chief Executive Officer was appointed during 2004, the Committee undertook a fresh investigation of the available information before arriving at the current CEO salary structure.

Base salary levels for the other Named Executive Officers are benchmarked against salary levels of senior operational management located in the Company s regional and divisional offices. Operational management salaries are determined in accordance with a compensation plan that considers both objective factors such as sales volume and profitability and subjective factors. The Company started using a balanced scorecard system in 2006 for the purposes of determining operational management s performance.

Awards of executive bonuses depend upon whether the Company has met pre-tax earnings targets established by the Compensation Committee and approved by the Board of Directors. The pre-tax earnings target for the purposes of the 2006 bonus calculation was $82.5 million. At that level, the bonus pool available to the participants would have been equal to 50% of their combined base salaries. The amount of such bonuses is not subject to any minimum amount but is subject to a maximum of 150% of the combined base salaries of the participants. The amounts of the executive bonus awards are linked directly to a formula that provides bonus amounts that increase as pre-tax earnings (adjusted to exclude amounts not considered part of the Company s normal operations) approach the target level and accelerated amounts if adjusted pre-tax earnings exceed the target level. A similar formula is used to calculate a portion of the CEO s annual bonus award. The Compensation Committee undertook a formal evaluation process involving interviews with members of senior management to determine the remainder of the CEO s bonus in 2006.

The CEO and other Named Executive Officers, as well as all participants in the Company s ELTIP, are subject to share ownership guidelines that specify the dollar value of Company stock required to be held by all participants. The values are determined as a multiple of each participant s base salary. The share ownership guidelines in effect in 2006 were as

follows: members of the Executive Council, including the Named Executive Officers, were required to hold Company stock with a cost of three times their base salary at February 1, 2006 and all Vice-Presidents of the Company were required to hold Company stock with a cost of two times their base salary at February 1, 2006.

Report presented by:
Charles E. Croft (Chairman)
Robert W. Murdoch
C. Russell Cmolik

Performance Graph

The following graph compares the percentage change in the value of U.S.$100 invested in Common Shares of the Company with U.S.$100 invested in the Russell 2000 Index from December 31, 2001 to December 31, 2006 (the Company s most recent financial year end).

	Dec. 31, 2001	**Dec. 31, 2002**	**Dec. 31, 2003**	**Dec. 31, 2004**	**Dec. 31, 2005**	**Dec. 31, 2006**
Ritchie Bros. Auctioneers (RBA)	100	130	213	266	340	430
Russell 2000 Index	100	78	114	133	138	161

Directors and Senior Executives Liability Insurance and Indemnity Agreements

The Company maintains directors and senior executives liability insurance which, subject to the provisions contained in the policy, protects the directors and senior executives, as such, against certain claims made against them during their term of office. Such insurance provides for an aggregate of U.S.$20 million annual protection against liability (less a deductible of U.S.$750,000 for securities claims and U.S.$250,000 for other claims) and U.S.$5 million of excess coverage for directors only. The annual premium paid by the Company in 2006 for this insurance was U.S.$230,000. The Company also has entered into indemnity agreements with directors and senior officers of the Company to provide certain indemnification to such directors and senior officers, as permitted by the Canada Business Corporation Act.

SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS

The Company has a stock option plan that provides for the award of stock options to employees, directors and officers of the Company and to other persons approved by the Compensation Committee. The maximum number of Common Shares reserved for issuance under the stock option plan is 3,000,000 Common Shares (being 9% of total issued and outstanding shares at the date of this Information Circular), of which 1,286,468 Common Shares (being 4% of total issued and outstanding shares) have been issued, 793,648 Common Shares are reserved for issuance upon exercise of options that have been granted (2% of total issued and outstanding shares) and 919,884 Common Shares (3% of total issued and outstanding shares) remain available for future options to be granted. Stock options are granted at the closing market price of the Common Shares on the NYSE as of the grant date.

Options granted under the stock option plan are subject to vesting conditions imposed by the Compensation Committee. Most of the options granted under the stock option plan are subject to vesting one year from the grant date. The term of the options is generally 10 years from the date of grant and all options are not transferable. Unless otherwise determined by the Compensation Committee, the outstanding options will remain exercisable until the earliest of: (i) 10 years from the date of grant, (ii) 30 days from the date on which the optionee ceases to be employed by, or provide services to, the Company, or (iii) if the optionee s employment or eligibility ceases by reason of his or her death or if the optionee dies prior to the expiration of the 30-day period described in clause (ii) above, 180 days from the date of death.

Please refer to the section entitled Amendments to the Stock Option Plan for a discussion of the proposed amendments to the stock option plan.

The following table sets out the number of securities authorized for issuance under the Company s stock option plan at the date of this Information Circular:

	Number of Securities to be Issued upon Exercise of Outstanding Options (A)	**Weighted-Average Exercise Price of Outstanding Options**	**Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans (Excluding (A))**
Equity compensation plans approved by security holders stock option plan (1)	793,648 (2% of total issued and outstanding shares)	$22.05	919,884 (3% of total issued and outstanding shares)

(1) This information does not reflect the proposed amendments to the Stock Option Plan as described above.

Equity-based Compensation Awards Grant Policy

The Company s Board of Directors has adopted a Stock Option Granting Policy (the Policy), the terms of which establish guidelines for the granting of options to purchase Company stock to the Named Executive Officers and other employees of the Company. Under the provisions of the Policy, only the Compensation Committee of the Company s Board of Directors can authorize the granting of stock options to the Named Executive Officers and other executives of the Company. The Policy establishes an annual date for the granting of stock options, which falls on the fifth business day following the release of the Company s results for the most recently completed fiscal year. The Policy prohibits the granting of stock options during black out periods, as defined in the Company s Policy Regarding Securities Trades by Company Personnel. The Compensation Committee has delegated to the CEO the authority to grant options to purchase up to 50,000 common shares of the Company per year to Company employees, provided no one individual is granted more than 15,000 options and provided options are not granted to employees at the Vice-President and above level. Option grants by the CEO must fall within the Company s established trading windows. All stock options granted in accordance with the Policy must have an exercise price equal to the closing price of the Company s common stock on the New York Stock Exchange on the date of grant.

REPORT ON CORPORATE GOVERNANCE

The Board and the Company believe that good corporate governance practices are essential for the effective and prudent operation of the Company and for enhancing shareholder value. The Board s Nominating and Corporate Governance Committee is responsible for reviewing and, if deemed necessary, recommending changes to the Company s corporate governance practices.

In June 2005, National Instrument 58-101 Disclosure of Corporate Governance Practices (the Instrument), and a related National Policy 58-201, Corporate Governance Guidelines (the Guidelines) established by the Canadian Securities Administrators (CSA), came into effect and replaced the TSX guidelines for effective corporate governance. The table below sets out disclosure requirements of Form 58-101F1 under the Instrument and the Company s corresponding corporate governance disclosure.

In addition, any foreign private issuer listed on the NYSE is required to report any significant ways in which its corporate governance practices differ from those required for United States companies under NYSE listing standards. The Company is in conformance with the NYSE corporate governance requirements (the NYSE Rules) applicable to United States companies.

Additional information about the Company s corporate governance practices, including copies of the charters of the committees of the Company s Board of Directors, can be found on the Company s website at www.rbauction.com.

Disclosure Requirements under 58-101F1	Company Disclosure
1. Board of Directors	Directors during 2006:
(a) Disclose the identity of directors who are independent.	Charles E. Croft independent;
(b) Disclose the identity of directors who are not independent, and describe the basis for that determination.	Robert W. Murdoch independent; Edward B. Pitoniak independent;
(c) Disclose whether or not a majority of directors are independent. If a majority of directors are not independent, describe what the board of directors (the board) does to facilitate its exercise of independent judgement in carrying out its responsibilities.	Eric Patel independent; Beverley A. Briscoe independent; C. Russell Cmolik independent Mr. Cmolik retired from the position of President and COO of the Company in July 2002; however, he was deemed by the Board to be an independent director effective August 2005;
(d) If a director is presently a director of any other issuer that is a reporting issuer (or the equivalent) in a jurisdiction or a foreign jurisdiction, identify both the director and the other issuer.	David E. Ritchie non-independent director Mr. Ritchie retired from his position as CEO effective October 31, 2004. Mr. Ritchie retired from his position as Chairman effective November 30, 2006; and Peter J. Blake non-independent director Mr. Blake is an executive officer of the Company (CEO). The Board determined the independence of the foregoing directors in accordance with applicable NYSE listing

standards and corporate governance rules and, with respect to the Audit Committee, SEC independence standards. The directors who are noted as independent above also satisfy the independence requirements under the Instrument and the Guidelines.

Mr. Ritchie is a significant shareholder of the Company, beneficially owning or controlling 9.8% of the outstanding Common Shares as of the date of this Information Circular. Mr. Cmolik beneficially owned 7.7% of the outstanding Common Shares as of the date of this Information Circular.

The Board is responsible for determining whether or not each director is an *independent director.* To do this, the Board analyzes all material relationships of the directors with the Company and its subsidiaries.

The Board considers Mr. Croft, Mr. Patel, Ms. Briscoe, Mr. Murdoch, Mr. Cmolik and Mr. Pitoniak to be independent as none of them has any material relationship with the Company. Mr. Cmolik served as President and COO of the Company until July 2002 and was considered independent effective August 2005. Mr. Ritchie is not independent because he served as CEO of the Company until October 31, 2004 and Mr. Blake is not independent as a result of his employment with the Company as CEO. A majority of the directors are independent.

None of the independent directors works in the day-to-day operations of the Company, is party to any material contracts with the Company, receive, directly or indirectly, any fees or compensation from the Company other than as directors, or has any other material relationships with the Company (either directly or as a partner,

Disclosure Requirements under 58-101F1	Company Disclosure
	shareholder or officer of an organization that has a relationship with the Company). For directorships of the directors of the Company in other reporting issuers (or equivalent), please refer to disclosure on page 2.
(e) Disclose whether or not the independent directors hold regularly scheduled meetings at which non-independent directors and members of management are not in attendance. If the independent directors hold such meetings, disclose the number of meetings held since the beginning of the issuer s most recently completed financial year. If the independent directors do not hold such meetings, describe what the board does to facilitate open and candid discussion among its independent directors.	The independent directors held four meetings and several informal sessions in 2006 without management present. These meetings were chaired by Mr. Croft. Such meetings are scheduled regularly during the year, often immediately before the Board s Audit Committee or Board meetings.
(f) Disclose whether or not the chair of the board is an independent director. If the board has a chair or lead director who is an independent director, disclose the identity of the independent chair or lead director, and describe his or her role and responsibilities. If the board has neither a chair that is independent nor a lead director that is independent, describe what the board does to provide leadership for its independent directors.	Mr. Croft was the Lead Director of the Board until November 30, 2006, when he became Chairman. The Company no longer has a Lead Director because Mr. Croft is an independent director. Mr. Croft is responsible for coordinating the activities of the independent directors and administering the Board s relationship with management and the CEO. His role is to ensure greater independence of the Board from management and to act as a liaison between management and the Board.
(g) Disclose the attendance record of each director for all board meetings held since the beginning of the issuer s most recently completed financial year.	Please refer to disclosure on page 3 for Board and Committee meeting attendance. The Board achieved an attendance record of 92% in 2006. Agenda and materials in relation to Board and Committee meetings are usually circulated to directors for their review in advance of the meetings.
2. Board Mandate Disclose the text of the board s written mandate. If the board does not have a written mandate, describe how the board delineates its role and responsibilities.	The Board mandate is available on the Company s website (www.rbauction.com). The mandate of the Board is to supervise management of the Company and to act in the best interests of the Company. The Board acts in accordance with: the Canadian Business Corporations Act; the Company s Articles of Amalgamation and By-laws; the Company s Code of Business Conduct and Ethics;

the charters of the Board committees, including the Audit Committee, the Compensation Committee and the Nominating and Corporate Governance Committee;

the Company s Corporate Governance Guidelines; and

other applicable laws and Company policies.

The Board or designated Board Committees approve significant decisions that affect the Company and its subsidiaries before they are implemented. The Board or a designated committee supervises the implementation of such decisions and reviews the results. Copies of the Company s Code of Business Conduct and Ethics and charters of the Board committees can be found on the Company s website.

The Board meets with the CEO and other executive officers of the Company from time to time to discuss and review internal measures and systems adopted by the management to ensure a culture of integrity throughout the organization.

The Board is involved in the Company s strategic planning process. The Board is responsible for reviewing and approving strategic initiatives, taking into account the risks and opportunities of the business. Management updates the Board on the Company s performance in relation to strategic initiatives at least quarterly. Management has undertaken a strategic planning process, with regular Board involvement in the process. During fiscal 2006, there were ten meetings of the Board. The frequency of meetings and the nature of agenda items change depending upon the state of the Company s affairs.

The Board, through the Audit Committee, is responsible for overseeing the identification of the principal risks of the Company and ensuring that risk management systems are implemented. The principal risks of the Company include those related to the Company s industry, the environment and foreign currencies. The Audit Committee meets regularly to review reports from management of the Company and discuss significant risk areas with management and the external auditors. The Board, through the Audit Committee, ensures that the Company adopts appropriate risk management policies.

The Board is responsible for choosing the CEO, appointing the Executive Officers and for monitoring their performance. The Nominating and Corporate Governance

Committee is responsible for developing guidelines and procedures for selection and long-range succession planning for the Chief Executive Officer, and the Committee also ensures that processes are in place to recruit qualified senior managers, and to

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Disclosure Requirements under 58-101F1

Total income tax benefit related to other comprehensive income		(352,089)	(748,515)
Total other comprehensive loss, net of tax		(495,069)	(1,173,218)
Total comprehensive income	$	1,740,000	103,559

See accompanying notes to consolidated financial statements.

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PEOPLES BANCORP OF NORTH CAROLINA, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Three months ended March 31, 2006 and 2005

		2006	2005
		(Unaudited)	*(Unaudited)*
Cash flows from operating activities:			
Net earnings	$	2,235,069	1,276,777
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation, amortization and accretion		360,180	406,394
Provision for loan losses		759,000	690,000
Loss on sale of investment securities		81,800	-
Recognition of loss on sale of derivative instruments		196,101	-
Amortization of deferred gain on sale of premises		(5,224)	(5,224)
Gain on sale of repossessed assets		(13,368)	(3,067)
Stock option compensation expense		1,423	-
Change in:			
Mortgage loans held for sale		(323,300)	692,825
Cash surrender value of life insurance		(51,727)	(114,392)
Other assets		(1,870,200)	(621,170)
Other liabilities		215,343	44,887
Net cash provided by operating activities		1,585,097	2,367,030
Cash flows from investing activities:			
Purchases of investment securities available for sale		(3,754,753)	(3,014,262)
Proceeds from calls and maturities of investment securities available for sale		1,574,444	3,060,492
Proceeds from sales of investment securities available for sale		2,918,200	-
Purchases of other investments		(3,085,200)	(2,600,290)
Proceeds from sale of other investments		3,091,500	1,917,000
Net change in loans		(24,465,589)	(5,904,998)
Purchases of premises and equipment		(408,152)	(533,451)
Proceeds from sale of repossessed assets		229,126	42,696
Purchases of derivative financial instruments		(562,500)	-
Net cash used by investing activities		(24,462,924)	(7,032,813)
Cash flows from financing activities:			
Net change in deposits		30,661,357	1,731,872
Net change in demand notes payable to U.S. Treasury		(1,351,924)	100,317
		2,924,058	-

Net change in securities sold under agreement to repurchase			
Proceeds from FHLB borrowings		103,900,000	77,300,000
Repayments of FHLB borrowings		(106,000,000)	(75,300,000)
Proceeds from exercise of stock options		185,495	41,498
Common stock repurchased		(425,000)	-
Cash paid in lieu of fractional shares		-	(4,700)
Cash dividends paid		(379,995)	(345,141)
Net cash provided by financing activities		29,513,991	3,523,846
Net change in cash and cash equivalent		6,636,164	(1,141,937)
Cash and cash equivalents at beginning of period		19,815,999	16,790,871
Cash and cash equivalents at end of period	$	26,452,163	15,648,934

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PEOPLES BANCORP OF NORTH CAROLINA, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows, continued

Three months ended March 31, 2006 and 2005

		2006 (Unaudited)	2005 (Unaudited)
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	$	4,932,390	3,410,312
Income taxes	$	319,500	-
Noncash investing and financing activities:			
Change in unrealized gain (loss) on investment securities available for sale, net	$	(364,197)	(978,469)
Change in unrealized gain (loss) on derivative financial instruments, net	$	(130,872)	(194,749)
Transfer of loans to other real estate and repossessions	$	29,610	21,978
Transfer of retained earnings to common stock for issuance of stock dividend	$	-	6,274,087

See accompanying notes to consolidated financial statements.

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PEOPLES BANCORP OF NORTH CAROLINA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (*Unaudited*)

(1) Summary of Significant Accounting Policies

The consolidated financial statements include the financial statements of Peoples Bancorp of North Carolina, Inc. and its wholly owned subsidiary, Peoples Bank (the "Bank"), along with the Bank's wholly owned subsidiaries, Peoples Investment Services, Inc. and Real Estate Advisory Services, Inc. (collectively called the "Company"). All significant intercompany balances and transactions have been eliminated in consolidation.

The consolidated financial statements in this report are unaudited. In the opinion of management, all adjustments (none of which were other than normal accruals) necessary for a fair presentation of the financial position and results of operations for the periods presented have been included. Management of the Company has made a number of estimates and assumptions relating to reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these consolidated financial statements in conformity with generally accepted accounting principles. Actual results could differ from those estimates.

The Company's accounting policies are fundamental to understanding management's discussion and analysis of results of operations and financial condition. Many of the Company's accounting policies require significant judgment regarding valuation of assets and liabilities and/or significant interpretation of the specific accounting guidance. A description of the Company's significant accounting policies can be found in Note 1 of the notes to consolidated financial statements in the Company's 2006 Annual Report to Shareholders which is Appendix A to the Proxy Statement for the May 4, 2006 Annual Meeting of Shareholders.

(2) Allowance for Loan Losses

The following is an analysis of the allowance for loan losses for the three months ended March 31, 2006 and 2005:

		2006	2005
Balance, beginning of period	$	7,424,782	8,048,627
Provision for loan losses		759,000	690,000
Less:			
Charge-offs		(586,039)	(1,404,263)
Recoveries		51,621	85,216
Net charge-offs		(534,418)	(1,319,047)
Balance, end of period	$	7,649,364	7,419,580

(3) Net Earnings Per Share

Net earnings per common share is based on the weighted average number of common shares outstanding during the period while the effects of potential common shares outstanding during the period are included in diluted earnings per share. The average market price during the year is used to compute equivalent shares. All previously reported per share amounts have been restated to reflect a 10% stock dividend approved on April 20, 2006 by the Board of Directors of the Company.

The reconciliation of the amounts used in the computation of both "basic earnings per share" and "diluted earnings per share" for the three months ended March 31, 2006 and 2005 is as follows:

For the three months ended March 31, 2006

		Net Earnings	Common Shares		Per Share Amount
Basic earnings per share	$	2,235,069	3,791,549	$	0.59
Effect of dilutive securities:					
Stock options		-	85,484		
Diluted earnings per share	$	2,235,069	3,877,033	$	0.58

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For the three months ended March 31, 2005

		Net Earnings	Common Shares		Per Share Amount
Basic earnings per share	$	1,276,777	3,795,301	$	0.34
Effect of dilutive securities:					
Stock options		-	58,653		
Diluted earnings per share	$	1,276,777	3,853,955	$	0.33

(4) Derivative Financial Instruments and Hedging Activities

The Company entered into a new interest rate floor contract with a notional amount of $45.0 million during the first quarter of 2006. This derivative instrument is used to hedge future cash flows of the first $45.0 million of certain variable rate home equity loans against the downward effects of their repricing in the event of a decreasing rate environment for a period of three years ending in January 2009. If the prime rate falls below 7.50% during the term of this contract, the Company will receive payments based on the $45.0 million notional amount times the difference between 7.50% and the weighted average prime rate for the quarter. No payments will be received by the Company if the weighted average prime rate is 7.50% or higher. The Company paid a premium of $562,500 on this contract.

(5) Stock-Based Compensation

The Company has an Omnibus Stock Ownership and Long Term Incentive Plan (the "Plan") whereby certain stock-based rights, such as stock options, restricted stock, performance units, stock appreciation rights, or book value shares, may be granted to eligible directors and employees. A total of 354,046 shares were reserved for possible issuance under this Plan. All rights must be granted or awarded within ten years from the 1999 effective date.

Under the Plan, the Company granted incentive stock options to certain eligible employees in order that they may purchase Company stock at a price equal to the fair market value on the date of the grant. The options granted in 1999 vest over a five-year period. Options granted subsequent to 1999 vest over a three-year period. All options expire after ten years. The Company did not grant any options during the three months ended March 31, 2006.
A summary of the activity for the three months ended March 31, 2006 is presented below:

	Three months ended March 31, 2006			
	Shares	Weighted Average Option Price Per Share	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding, beginning of period	193,743	$ 13.41		
Granted during the period	-	-		
Forfeited during the period	-	-		
Exercised during the period	(13,980)	13.27		
Outstanding, end of period	179,763	$ 13.42	5.51	$ 2,441,268
Number of shares exercisable	176,829	$ 13.36	5.46	$ 2,412,582

The Company adopted Statement of Financial Accounting Standards ("SFAS") No. 123(R), Share-Based Payment ("SFAS No. 123(R)"), on January 1, 2006 using the "modified prospective" method. Under this method, awards that are granted, modified, or settled after December 31, 2005, are measured and accounted for in accordance with SFAS No. 123(R). Also under this method, expense is recognized for unvested awards that were granted prior to January 1, 2006, based upon the fair value determined at the grant date under SFAS No. 123, Accounting for Stock-Based Compensation ("SFAS No. 123"). The Company recognized compensation expense for employee stock options of $1,400 for the three months ended March 31, 2006. The Company did not recognize any tax benefit on compensation expense from employee stock options in the first quarter of 2006. As of March 31, 2006, there was $6,000 of total unrecognized compensation cost related to nonvested employee stock options, which is

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expected to be recognized over a period of 2 years. The Company did not recognize any compensation expense for employee stock options for the three months ended March 31, 2005.

Prior to the adoption of SFAS No. 123(R), the Company accounted for stock compensation under Accounting Principles Board Opinion No. 25 and related interpretations. Accordingly, the Company previously recognized no compensation cost for employee stock options. The following table illustrates the effect on net earnings and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 as of March 31, 2005.

			Three months ended March 31, 2005
Net earnings	As reported	$	1,276,777
	Effect of grants		(43,195)
	Effect of forfeitures		7,880
	Proforma	$	1,241,462
Basic earnings per share	As reported	$	0.34
	Proforma	$	0.33
Diluted earnings per share	As reported	$	0.33
	Proforma	$	0.32

No options were granted during the three months ended March 31, 2006 and 2005. The total intrinsic value (amount by which the fair market value of the underlying stock exceeds the exercise price of an option on exercise date) of options exercised during the three months ended March 31, 2006 and 2005 was $141,000 and $14,000, respectively. No options vested during the three months ended March 31, 2006 and 2005.

Cash received from option exercises for the three months ended March 31, 2006 and 2005 was $185,000 and $41,000, respectively. The tax benefit for the tax deductions from option exercises totaled $56,000 and $6,000, respectively for the three months ended March 31, 2006 and 2005.

(6) Subsequent Event

On April 20, 2006, the Board of Directors of the Company authorized a 10% stock dividend. As a result of the stock dividend, each shareholder will receive one new share of stock for every ten shares of stock they hold as of the record date. Shareholders will receive a cash payment in lieu of any fractional shares resulting from the stock dividend. The cash dividend will be paid based on the number of shares held by shareholders as adjusted by the stock dividend. All previously reported per share amounts have been restated to reflect this stock dividend.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Introduction

Management's discussion and analysis of earnings and related data are presented to assist in understanding the consolidated financial condition and results of operations of Peoples Bancorp of North Carolina, Inc. Peoples Bancorp is the parent company of Peoples Bank (the "Bank") and a registered bank holding company operating under the supervision of the Federal Reserve Board. The Bank is a North Carolina-chartered bank, with offices in Catawba, Lincoln, Alexander Mecklenburg and Iredell counties, operating under the banking laws of North Carolina and the rules and regulations of the Federal Deposit Insurance Corporation (the "FDIC").

Overview

Our business consists principally of attracting deposits from the general public and investing these funds in loans secured by commercial real estate, secured and unsecured commercial and consumer loans. Our profitability depends primarily on our net interest income, which is the difference between the income we receive on our loan and investment securities portfolios and our cost of funds, which consists of interest paid on deposits and borrowed funds. Net interest income also is affected by the relative amounts of interest-earning assets and interest-bearing liabilities. When interest-earning assets approximate or exceed interest-bearing liabilities, any positive interest rate spread will generate net interest income. Our profitability is also affected by the level of other income and operating expenses. Other income consists primarily of miscellaneous fees related to our loans and deposits, mortgage banking income and commissions from sales of annuities and mutual funds. Operating expenses consist of compensation and benefits, occupancy related expenses, federal deposit and other insurance premiums, data processing, advertising and other expenses.

Our operations are influenced significantly by local economic conditions and by policies of financial institution regulatory authorities. The earnings on our assets are influenced by the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System, inflation, interest rates, market and monetary fluctuations. Lending activities are affected by the demand for commercial and other types of loans, which in turn is affected by the interest rates at which such financing may be offered. Our cost of funds is influenced by interest rates on competing investments and by rates offered on similar investments by competing financial institutions in our market area, as well as general market interest rates. These factors can cause fluctuations in our net interest income and other income. In addition, local economic conditions can impact the credit risk of our loan portfolio, in that local employers may be required to eliminate employment positions of borrowers, and small businesses and other commercial borrowers may experience a downturn in their operating performance and become unable to make timely payments on their loans. Management evaluates these factors in estimating its allowance for loan losses, and changes in these economic conditions could result in increases or decreases to the provision for loan losses.

Our business emphasis has been to operate as a well-capitalized, profitable and independent community-oriented financial institution dedicated to providing quality customer service. We are committed to meeting the financial needs of the communities in which we operate. We believe that we can be more effective in servicing our customers than many of our non-local competitors because of our ability to quickly and effectively provide senior management responses to customer needs and inquiries. Our ability to provide these services is enhanced by the stability of our senior management team.

The Federal Reserve has increased the Federal Funds Rate a total of 2.75% since December 31, 2004 with the rate set at 7.75% as of March 31, 2006. These increases had a positive impact on first quarter earnings and should continue to have a positive impact on the Bank's net interest income in the future periods. The positive impact from the increase in the Federal Funds Rate has been partially offset by the decrease in earnings realized on interest rate contracts, including both interest rate swaps and interest rate floors, utilized by the Company. The swaps were put in place during the time that the Federal Funds Rate approached 1.00% and helped to offset the decline in income experienced in 2003 and 2004 because of the reductions in the Federal Funds Rate that the Federal Reserve implemented from January 2001 to June 2003. Additional information regarding the Company's interest rate contacts is provided below in the section entitled "Asset Liability and Interest Rate Risk Management."

Summary of Significant Accounting Policies

The consolidated financial statements include the financial statements of Peoples Bancorp of North Carolina, Inc. and its wholly owned subsidiary, Peoples Bank, along with the Bank's wholly owned subsidiaries, Peoples Investment Services, Inc. and Real Estate Advisory Services, Inc. (collectively called the "Company"). All significant intercompany balances and transactions have been eliminated in consolidation.

The Company's accounting policies are fundamental to understanding management's discussion and analysis of results of operations and financial condition. Many of the Company's accounting policies require significant judgment regarding valuation of assets and liabilities and/or significant interpretation of specific accounting guidance. The following is a summary of some of the more subjective and complex accounting policies of the Company. A more complete description of the Company’s significant accounting policies can be found in Note 1 of the Notes to Consolidated Financial Statements in the Company’s 2006 Annual Report to Shareholders which is Appendix A to the Proxy Statement for the May 4, 2006 Annual Meeting of Shareholders. The following is a summary of the more subjective and complex accounting policies of the Company.

Many of the Company’s assets and liabilities are recorded using various techniques that require significant judgment as to recoverability. The collectability of loans is reflected through the Company’s estimate of the allowance for loan losses. The Company performs periodic and systematic detailed reviews of its lending portfolio to assess overall collectability. In addition, certain assets and liabilities are reflected at their estimated fair value in the consolidated financial statements. Such amounts are based on either quoted market prices or estimated values derived from dealer quotes used by the Company, market comparisons or internally generated modeling techniques. The Company’s internal models generally involve present value of cash flow techniques. The various techniques are discussed in greater detail elsewhere in management’s discussion and analysis and the notes to the consolidated financial statements.

There are other complex accounting standards that require the Company to employ significant judgment in interpreting and applying certain of the principles prescribed by those standards. These judgments include, but are not limited to, the determination of whether a financial instrument or other contract meets the definition of a derivative in accordance with Statement of Financial Accounting Standards No. 133, “Accounting for Derivative Instruments and Hedging Activities.” For a more complete discussion of policies, see the notes to the consolidated financial statements.

In December 2004, the FASB revised SFAS No. 123 (“SFAS No. 123 (R)”). SFAS No. 123 (R), “Share-Based Payment”, requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. Pro forma disclosure is no longer an alternative to financial statement recognition. SFAS No. 123 (R) is effective for periods beginning after December 31, 2005. The Company recognized compensation expense for employee stock options of $1,400 for the three months ended March 31, 2006. The Company did not recognize any tax benefit on compensation expense from employee stock options in the first quarter of 2006.

Management of the Company has made a number of estimates and assumptions relating to reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these consolidated financial statements in conformity with generally accepted accounting principles. Actual results could differ from those estimates.

Results of Operations

Summary. Net earnings for the first quarter of 2006 were $2.2 million, or $0.59 basic net earnings per share and $0.58 diluted net earnings per share as compared to $1.3 million, or $0.34 basic net earnings per share and $0.33 diluted net earnings per share for the same period one year ago. Net earnings from recurring operations as of March 31, 2006 were $2.4 million, or $0.63 basic net income per share and $0.62 diluted net income per share, as compared to the first quarter of 2005 net income from recurring operations of $1.3 million, or $0.34 basic net income per share and $0.33 diluted net income per share. The increase in net earnings is primarily attributable to growth in interest-earning assets, which contributed to increases in net interest income, and non-interest income, which were partially offset by increases in the provision for loan losses and non-interest expense.

The annualized return on average assets was 1.22% for the three months ended March 31, 2006 compared to 0.75% for the same period in 2005, and annualized return on average shareholders' equity was 16.04% for the three months ended March 31, 2006 compared to 9.96% for the same period in 2005.

Net Interest Income. Net interest income, the major component of the Company's net earnings, was $8.0 million for the three months ended March 31, 2006, an increase of 28% over the $6.2 million earned in the same period in 2005. The increase in net interest income for the first quarter of 2006 was primarily attributable to increases in the prime rate resulting from Federal Reserve interest rate increases combined with increases in the average outstanding balances of loans and investment securities available-for-sale.

Interest income increased $3.3 million or 34% for the three months ended March 31, 2006 compared with the same period in 2005. The increase was due to an increase in the average yield received on loans resulting from Federal Reserve interest rate increases combined with an increase in the average outstanding balance of loans and investment securities available-for-sale. During the quarter ended March 31, 2006, average loans increased $41.6 million to $580.5 million from $538.9 million for the three months ended March 31, 2005. During the quarter ended March 31, 2006, average investment securities available-for-sale increased $12.2 million to $116.7 million from $104.5 million for the three months ended March 31, 2005.

Interest expense increased $1.5 million or 45% for the three months ended March 31, 2006 compared with the same period in 2005. The increase in interest expense was due to an increase in the cost of funds to 3.32% for the three months ended March 31, 2006 from 2.46% for the same period in 2005, combined with an increase in volume of interest-bearing liabilities. The increase in the cost of funds is primarily attributable to increases in the average rate paid on interest-bearing checking and savings accounts and certificates of deposit. The average rate paid on interest-bearing checking and savings accounts was 1.58% for the three months ended March 31, 2006 as compared to 1.34% for the same period of 2005. The average rate paid on certificates of deposits was 3.75% for the three months ended March 31, 2006 compared to 2.60% for the same period one year ago.

Provision for Loan Losses. For the three months ended March 31, 2006, a contribution of $759,000 was made to the provision for loan losses compared to $690,000 for the same period one year ago.

Non-Interest Income. Total non-interest income was $1.9 million in the first quarter of 2006, an 18% increase over the $1.6 million for the same period in 2005. This increase is primarily due to an increase in service charge and fee income, mortgage banking income and other miscellaneous income. Service charges were $925,000 and $805,000 for the three months ended March 31, 2006 and 2005, respectively. This increase is primarily due to an increase of $74,000 in NSF fee income. Other service charges and fees increased 62% to $396,000 for the three-month period ended March 31, 2006 when compared to the same period one year ago. This increase is primarily attributable to an increase of $80,000 in check cashing fee income and an increase of $38,000 in miscellaneous fee income. Mortgage banking income increased $17,000 or 17% during the three months ended March 31, 2006 as compared to the corresponding period in 2005. Miscellaneous income was $488,000 for the three months ended March 31, 2006, a 29% increase from $378,000 for the same period in 2005. This increase in miscellaneous income was partially attributable to an increase of $45,000 in debit card fee income primarily associated with increased card usage due to an increased number of demand accounts and a $27,000 increase in income from the Bank's Real Estate Advisory Services, Inc. subsidiary. These increases were partially offset by an $82,000 loss on sale of securities. Recurring non-interest income amounted to $2.0 million and $1.6 million for the three months ended March 31, 2006 and 2005, respectively. The increase in recurring non-interest income is primarily due to an increase in service charges and fees, miscellaneous other income and an increase mortgage banking income. Net non-recurring losses on the disposition of assets totaled $63,000 and consisted primarily of losses on the sale of securities.

Non-Interest Expense. Total non-interest expense increased 8% to $5.7 million for the first quarter of 2006 as compared to $5.3 million for the corresponding period in 2005. Salary and employee benefits totaled $3.2 million for the three months ended March 31, 2006, an increase of 6% from the same period in 2005. The increase in salary and employee benefits is due to normal salary increases and increased employee incentive expense. Occupancy expense increased 2% for the quarter ended March 31, 2006. Other non-interest expense increased 20% to $1.5 million for the three months ended March 31, 2006 as compared to the same period in 2005. This increase in other non-interest expense is attributable to a $178,000 prepayment fee associated with the early termination of a $5 million Federal Home Loan Bank advance in the first quarter of 2006. Recurring non-interest expense increased 5% to $5.5 million for the three months ended March 31, 2006, as compared to $5.3 million for the same period last year.

*Income Taxes.*The Company reported income taxes of $1.2 million and $647,000 for the first quarters of 2006 and 2005, respectively. This represented effective tax rates of 36% and 34% for the respective periods.

Analysis of Financial Condition

*Investment Securities.*Available-for-sale securities amounted to $113.8 million at March 31, 2006 compared to $115.2 million at December 31, 2005. This decrease is primarily the result of paydowns on mortgage-backed securities, calls and maturities, which were partially offset by additional securities purchases. Average investment securities available for sale for the three months ended March 31, 2006 amounted to $116.6 million compared to $108.7 million for the year ended December 31, 2005.

*Loans.*At March 31, 2006, loans amounted to $590.6 million compared to $566.7 million at December 31, 2005, an increase of $23.9 million. Average loans represented 82% of total earning assets for the three months ended March 31, 2006 and the year ended December 31, 2005. Mortgage loans held for sale were $2.6 million and $2.2 million at March 31, 2006 and December 31, 2005, respectively.

Allowance for Loan Losses. The allowance for loan losses reflects management's assessment and estimate of the risks associated with extending credit and its evaluation of the quality of the loan portfolio. The Bank periodically analyzes the loan portfolio in an effort to review asset quality and to establish an allowance for loan losses that management believes will be adequate in light of anticipated risks and loan losses. In assessing the adequacy of the allowance, size, quality and risk of loans in the portfolio are reviewed. Other factors considered are:

- the Bank's loan loss experience;
- the amount of past due and non-performing loans;

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- specific known risks;
- the status and amount of other past due and non-performing assets;
- underlying estimated values of collateral securing loans;
- current and anticipated economic conditions; and
- other factors which management believes affect the allowance for potential credit losses.

An analysis of the credit quality of the loan portfolio and the adequacy of the allowance for loan losses is prepared by the Bank's credit administration personnel and presented to the Bank's Board of Directors on a regular basis. The allowance is the total of specific reserves allocated to significant individual loans plus a general reserve. After individual loans with specific allocations have been deducted, the general reserve is calculated by applying general reserve percentages to the nine risk grades within the portfolio. Loans are categorized as one of nine risk grades based on management's assessment of the overall credit quality of the loan, including payment history, financial position of the borrower, underlying collateral and internal credit review. The general reserve percentages are determined by management based on its evaluation of losses inherent in the various risk grades of loans. The allowance for loan losses is established through charges to expense in the form of a provision for loan losses. Loan losses and recoveries are charged and credited directly to the allowance.

The following table presents the percentage of loans assigned to each risk grade along with the general reserve percentage applied to loans in each risk grade at March 31, 2006 and December 31, 2005.

LOAN RISK GRADE ANALYSIS:	**Percentage of Loans By Risk Grade***		**General Reserve Percentage**	
	03/31/2006	**12/31/2005**	**03/31/2006**	**12/31/2005**
Risk 1 (Excellent Quality)	13.69%	14.28%	0.15%	0.15%
Risk 2 (High Quality)	17.62%	18.16%	0.50%	0.50%
Risk 3 (Good Quality)	58.26%	56.40%	1.00%	1.00%
Risk 4 (Management Attention)	7.50%	8.38%	2.50%	2.50%
Risk 5 (Watch)	1.15%	0.88%	7.00%	7.00%
Risk 6 (Substandard)	0.37%	0.42%	12.00%	12.00%
Risk 7 (Low Substandard)	0.59%	0.86%	25.00%	25.00%
Risk 8 (Doubtful)	0.00%	0.00%	50.00%	50.00%
Risk 9 (Loss)	0.00%	0.00%	100.00%	100.00%

*Excludes non-accrual loans

At March 31, 2006 there was one relationship which totaled $1.8 million in the Watch risk grade, no relationships exceeding $1.0 million in the Substandard risk grade and one relationship which totaled $3.1 million in the Low Substandard risk grade. These customers continue to meet payment requirements and these relationships would not become non-performing assets unless they are unable to meet those requirements.

An allowance for loan losses is also established, as necessary, for individual loans considered to be impaired in accordance with Statement of Financial Accounting Standards ("SFAS") No. 114. A loan is considered impaired when, based on current information and events, it is probable that all amounts due according to the contractual terms of the loan will not be collected. Impaired loans are measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, or at the loan's observable market price, or the fair value of collateral if the loan is collateral dependent. At March 31, 2006 and December 31, 2005, the recorded investment in loans that were considered to be impaired under SFAS No. 114 was approximately $4.9 million and $3.5 million, respectively, with related allowance for loan losses of approximately $628,000 and $478,000, respectively.

The allowance for loan losses totaled $7.6 million at March 31, 2006 and $7.4 million at December 31, 2005, which represented 1.30% of total loans outstanding at March 31, 2006 and 1.31% of total loans outstanding as of December 31, 2005.

The Bank's allowance for loan losses is also subject to regulatory examinations and determinations as to adequacy, which may take into account such factors as the methodology used to calculate the allowance for loan losses and the size of the allowance for loan losses compared to a group of peer banks identified by the regulators. During their routine examinations of banks, the FDIC and the North Carolina Commissioner of Banks may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

While it is the Bank's policy to charge off in the current period loans for which a loss is considered probable, there are additional risks of future losses which cannot be quantified precisely or attributed to particular loans or classes of loans. Because these risks include the state of the economy, management's judgment as to the adequacy of the allowance is necessarily approximate and imprecise. After review of all relevant matters affecting loan collectability, management believes that the allowance for loan losses is appropriate.

The Company grants loans and extensions of credit primarily within the Catawba Valley region of North Carolina, which encompasses Catawba, Alexander, Iredell and Lincoln counties and also in Mecklenburg County. Although the Bank has a diversified loan portfolio, a substantial portion of the loan portfolio is collateralized by real estate, which is dependent upon the real estate market. Non-real estate loans also can be affected by local economic conditions. At March 31, 2006, approximately 5% of the Company's portfolio was not secured by any type of collateral. Unsecured loans generally involve higher credit risk than secured loans and, in the event of customer default, the Company has a higher exposure to potential loan losses.

Non-performing Assets. Non-performing assets totaled $5.2 million at March 31, 2006 or 0.68% of total assets, compared to $5.0 million at December 31, 2005, or 0.68% of total assets. Non-accrual loans were $4.9 million at March 31, 2006 and $3.5 million at December 31, 2005. As a percentage of total loans outstanding, non-accrual loans were 0.82% at March 31, 2006 compared to 0.62% at December 31, 2005. The Bank had no loans ninety days past due and still accruing at March 31, 2006 as compared to $946,000 at December 31, 2005. Other real estate owned totaled $345,000 as of March 31, 2006 as compared to $531,000 at December 31, 2005. The Bank had no repossessed assets as of March 31, 2006 or December 31, 2005.

Total non-performing loans, which include non-accrual loans and loans ninety days past due and still accruing, were $4.9 million and $4.4 million at March 31, 2006 and December 31, 2005, respectively. The ratio of non-performing loans to total loans was 0.82% at March 31, 2006, as compared to 0.79% at December 31, 2005.

Deposits. Total deposits at March 31, 2006 were $613.5 million, an increase of $30.6 million over deposits of $582.9 million at December 31, 2005. Core deposits, which include non-interest bearing demand deposits, NOW, MMDA, savings and certificates of deposits of denominations less than $100,000, decreased $1.2 million to $429.2 million at March 31, 2006 as compared to $430.4 million at December 31, 2005. Certificates of deposit in amounts greater than $100,000 or more totaled $184.3 million at March 31, 2006 as compared to $152.4 million at December 31, 2005. At March 31, 2006, brokered deposits amounted to $65.5 million as compared to $40.3 million at December 31, 2005. The increase in brokered deposits was necessary to fund increased loan demand. Brokered deposits outstanding as of March 31, 2006 had a weighted average rate of 4.30% with a weighted average original term of 12 months.

Borrowed Funds. Borrowings from the Federal Home Loan Bank of Atlanta ("FHLB") totaled $69.5 million at March 31, 2006 compared to $71.6 million at December 31, 2005. The average balance of FHLB borrowings for the three months ended March 31, 2006 was $79.7 million compared to $65.9 million for the year ended December 31, 2005. At March 31, 2006, FHLB borrowings with maturities exceeding one year amounted to $67.0 million. The FHLB has the option to convert $52.0 million of the total advances to a floating rate and, if converted, the Bank may repay advances without payment of a prepayment fee. The Company also has an additional $15.0 million in variable rate convertible advances, which may be repaid without a prepayment fee if converted by the FHLB. The Company had no federal funds purchased as of March 31, 2006 or December 31, 2005.

Securities sold under agreements to repurchase amounted to $3.9 million and $981,000 as of March 31, 2006 and December 31, 2005, respectively.

Junior Subordinated Debentures (related to Trust Preferred Securities). In December 2001 the Company formed a wholly owned Delaware statutory trust, PEBK Capital Trust I ("PEBK Trust"), which issued $14.0 million of guaranteed preferred beneficial interests in the Company's junior subordinated deferrable interest debentures that qualify as Tier 1 capital under Federal Reserve Board guidelines. All of the common securities of PEBK Trust are owned by the Company. The proceeds from the issuance of the common securities and the trust preferred securities were used by PEBK Trust to purchase $14.4 million of junior subordinated debentures of the Company, which pay a floating rate equal to prime plus 50 basis points. The proceeds received by the Company from the sale of the junior subordinated debentures were used for general purposes, primarily to provide capital to the Bank. The debentures represent the sole asset of PEBK Trust. PEBK Trust is not included in the consolidated financial statements.

The trust preferred securities accrue and pay quarterly distributions based on the liquidation value of $50,000 per capital security at a floating rate of prime plus 50 basis points. The Company has guaranteed distributions and other payments due on the trust preferred securities to the extent PEBK Trust has funds with which to make the distributions and other payments. The net combined effect of all the documents entered into in connection with the trust preferred securities is that the Company is liable to make the distributions and other payments required on the trust preferred securities.

The trust preferred securities are mandatorily redeemable upon maturity of the debentures on December 31, 2031, or upon earlier redemption as provided in the indenture. The Company has the right to redeem the debentures purchased by PEBK Trust, in whole or in part, on or after December 31, 2006. As specified in the indenture, if the debentures are redeemed prior to maturity, the redemption price will be the principal amount and any accrued but unpaid interest.

Asset Liability and Interest Rate Risk Management. The objective of the Company's Asset Liability and Interest Rate Risk strategies is to identify and manage the sensitivity of net interest income to changing interest rates and to minimize the interest rate risk between interest-earning assets and interest-bearing liabilities at various maturities. This is to be done in conjunction with the need to maintain adequate liquidity and the overall goal of maximizing net interest income.

The Company manages its exposure to fluctuations in interest rates through policies established by the Asset/Liability Committee ("ALCO") of the Bank. The ALCO meets monthly and has the responsibility for approving asset/liability management policies, formulating and implementing strategies to improve balance sheet positioning and/or earnings and reviewing the interest rate sensitivity of the Company. ALCO tries to minimize interest rate risk between interest-earning assets and interest-bearing liabilities by attempting to minimize wide fluctuations in net interest income due to interest rate movements. The ability to control these fluctuations has a direct impact on the profitability of the Company. Management monitors this activity on a regular basis through analysis of its portfolios to determine the difference between rate sensitive assets and rate sensitive liabilities.

The Company's rate sensitive assets are those earning interest at variable rates and those with contractual maturities within one year. Rate sensitive assets therefore include both loans and available-for-sale securities. Rate sensitive liabilities include interest-bearing checking accounts, money market deposit accounts, savings accounts, time deposits and borrowed funds. The Company's balance sheet is asset-sensitive, meaning that in a given period there will be more assets than liabilities subject to immediate repricing as interest rates change in the market. Because most of the Company's loans are tied to the prime rate, they reprice more rapidly than rate sensitive interest-bearing deposits. During periods of rising rates, this results in increased net interest income. The opposite occurs during periods of declining rates. Average rate sensitive assets for the three months ended March 31, 2006 totaled $705.0 million, exceeding average rate sensitive liabilities of $594.8 million by $110.2 million.

In order to assist in achieving a desired level of interest rate sensitivity, the Company entered into off-balance sheet contracts that are considered a derivative financial instrument. As of March 31, 2006, the Company had cash flow hedges with a notional amount of $115.0 million. These derivative instruments consist of three interest rate floor contracts that are used to hedge future cash flows of the first $115.0 million of certain variable rate commercial and home equity loans against the downward effects of their repricing in the event of a decreasing rate environment for a period of three years ending in July 2008, November 2008 and January 2009. If the prime rate falls below 6.25% during the term of the contract on the first floor, the Company will receive payments based on the $35.0 million notional amount times the difference between 6.25% and the weighted average prime rate for the quarter. No payments will be received by the Company if the weighted average prime rate is 6.25% or higher. The Company paid a premium of $161,000 on this contact. On the second floor if the prime rate falls below 7.00% during the term of the contract, the Company will receive payments based on the $35.0 million notional amount times the difference between 7.00% and the weighted average prime rate for the quarter. No payments will be received by the Company if the weighted average prime rate is 7.00% or higher. The Company paid a premium of $203,000 on this contract. On the third floor if the prime rate falls below 7.50% during the term of the contract on the third floor, the Company will receive payments based on the $45.0 million notional amount times the difference between 7.50% and the weighted average prime rate for the quarter. No payments will be received by the Company if the weighted average prime rate is 7.50% or higher. The Company paid a premium of $562,500 on this contract. The amortization expense recognized on these three interest rate floor contracts totaled $57,000 for the three month period ended March 31, 2006.

The Company settled two previously outstanding interest rate swap agreements during 2005. The first swap, with a notional amount of $25.0 million and scheduled to mature in April 2006 was sold for a loss of $318,000. The second swap with a notional amount of $30.0 million and scheduled to mature in September 2006 was sold for a loss of $552,000. The losses realized upon settlement are being recognized over the original term of the agreements and during the three-month period, ended March 31, 2006, losses of approximately $196,000 were recognized.

The Bank utilizes interest rate floors on certain variable rate loans to protect against further downward movements in the prime rate. At March 31, 2006, the Bank had $85.3 million in loans with interest rate floors; however, none of the floors were in effect pursuant to the terms of the promissory notes on these loans.

The Bank also had $17.2 million in loans with interest rate caps. The weighted average rate on these loans is 0.86% lower than the indexed rate on the promissory notes without the interest rate caps.

Liquidity. The objectives of the Company's liquidity policy are to provide for the availability of adequate funds to meet the needs of loan demand, deposit withdrawals, maturing liabilities and to satisfy regulatory requirements. Both deposit and loan customer cash needs can fluctuate significantly depending upon business cycles, economic conditions and yields and returns available from alternative investment opportunities. In addition, the Company's liquidity is affected by off-balance sheet commitments to lend in the form of unfunded commitments to extend credit and standby letters of credit. As of March 31, 2006 such unfunded commitments to extend credit were $136.1 million, while commitments in the form of standby letters of credit totaled $2.7 million.

The Company uses several sources to meet its liquidity requirements. The primary source is core deposits, which includes demand deposits, savings accounts and certificates of deposits of denominations less than $100,000. The Company considers these to be a stable portion of the Company's liability mix and the result of on-going consumer and commercial banking relationships. As of March 31, 2006, the Company's core deposits totaled $429.2 million, or 70% of total deposits.

The other sources of funding for the Company are through large denomination certificates of deposit, including brokered deposits, federal funds purchased and FHLB advances. The Bank is also able to borrow from the Federal Reserve System on a short-term basis.

At March 31, 2006, the Bank had a significant amount of deposits in amounts greater than $100,000, including brokered deposits of $65.5 million, which mature over the next two years. The balance and cost of these deposits are more susceptible to changes in the interest rate environment than other deposits.

The Bank had a line of credit with the FHLB equal to 20% of the Bank's total assets, with an outstanding balance of $69.5 million at March 31, 2006. The remaining availability at FHLB was $58.3 million at March 31, 2006. The Bank also had the ability to borrow up to $25.0 million for the purchase of overnight federal funds from two correspondent financial institutions as of March 31, 2006.

The liquidity ratio for the Bank, which is defined as net cash, interest bearing deposits with banks, federal funds sold, certain investment securities and certain FHLB advances available under the line of credit, as a percentage of net deposits (adjusted for deposit runoff projections) and short-term liabilities was 37.32% at March 31, 2006 and 36.81% at December 31, 2005. The minimum required liquidity ratio as defined in the Bank's Asset/Liability and Interest Rate Risk Management Policy is 20%.

Contractual Obligations and Off-Balance Sheet Arrangements. The Company's contractual obligations and other commitments as of March 31, 2006 and December 31, 2005 are summarized in the table below. The Company's contractual obligations include the repayment of principal and interest related to FHLB advances and junior subordinated debentures, as well as certain payments under current lease agreements. Other commitments include commitments to extend credit. Because not all of these commitments to extend credit will be drawn upon, the actual cash requirements are likely to be significantly less than the amounts reported for other commitments below.

CONTRACTUAL OBLIGATIONS AND OTHER COMMITMENTS:
(Dollars in Thousands)

		March 31, 2006	December 31, 2005
Contractual Cash Obligations			
Long-term borrowings	$	67,000	67,000
Junior subordinated debentures		14,433	14,433

Operating lease obligations		8,478	8,599
Total	$	89,911	90,032
Other Commitments			
Commitments to extend credit	$	136,121	133,409
Standby letters of credit and financial guarantees written		2,694	2,692
Total	$	138,815	136,101

The Company enters into derivative contracts to manage various financial risks. A derivative is a financial instrument that derives its cash flows, and therefore its value, by reference to an underlying instrument, index or referenced interest rate. Derivative contracts are carried at fair value on the consolidated balance sheet with the fair value representing the net present value of expected future cash receipts or payments based on market interest rates as of the balance sheet date. Derivative contracts are written in amounts referred to as notional amounts, which only provide the basis for

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calculating payments between counterparties and are not a measure of financial risk. Further discussions of derivative instruments are included above in the section entitled "Asset Liability and Interest Rate Risk Management".

Capital Resources. Shareholders' equity at March 31, 2006 was $55.5 million compared to $54.4 million at December 31, 2005. At March 31, 2006 and December 31, 2005, unrealized losses, net of taxes, amounted to $1.9 million and $1.4 million, respectively. The increase in unrealized losses at March 31, 2006 is primarily attributable to a decrease in the market value of available for sale securities and derivative instruments. Management expects that accumulated comprehensive income (loss) will continue to fluctuate due to changes in the market value of available for sale investments securities and derivative instruments caused by changes in market interest rates. Annualized return on average equity for the three months ended March 31, 2006 was 16.04% compared to 9.96% for the year ended December 31, 2005. Total cash dividends paid during the three months ended March 31, 2006 amounted to $380,000 as compared to total cash dividends of $345,000 paid for the first three months of 2005.

Since implementation of a stock repurchase plan implemented in November 2005, which expires in November 2006, the Company has repurchased $425,000, or 17,500 shares of its common stock.

Under the regulatory capital guidelines, financial institutions are currently required to maintain a total risk-based capital ratio of 8.0% or greater, with a Tier 1 risk-based capital ratio of 4.0% or greater. Tier 1 capital is generally defined as shareholders' equity and Trust Preferred Securities less all intangible assets and goodwill. The Company's Tier 1 capital ratio was 10.81% and 11.02% at March 31, 2006 and December 31, 2005, respectively. Total risk-based capital is defined as Tier 1 capital plus supplementary capital. Supplementary capital, or Tier 2 capital, consists of the Company's allowance for loan losses, not exceeding 1.25% of the Company's risk-weighted assets. Total risk-based capital ratio is therefore defined as the ratio of total capital (Tier 1 capital and Tier 2 capital) to risk-weighted assets. The Company's total risk-based capital ratio was 11.97% and 12.19% at March 31, 2006 and December 31, 2005, respectively. In addition to the Tier 1 and total risk-based capital requirements, financial institutions are also required to maintain a leverage ratio of Tier 1 capital to total average assets of 4.0% or greater. The Company's Tier 1 leverage capital ratio was 9.56% and 9.84% at March 31, 2006 and December 31, 2005, respectively.

The Bank's Tier 1 risk-based capital ratio was 10.30% and 10.46% at March 31, 2006 and December 31, 2005, respectively. The total risk-based capital ratio for the Bank was 11.47% and 11.64% at March 31, 2006 and December 31, 2005, respectively. The Bank's Tier 1 leverage capital ratio was 9.10% and 9.33% at March 31, 2006 and December 31, 2005, respectively.

A bank is considered to be "well capitalized" if it has a total risk-based capital ratio of 10.0 % or greater, a Tier 1 risk-based capital ratio of 6.0% or greater, and has a leverage ratio of 5.0% or greater. Based upon these guidelines, the Bank was considered to be "well capitalized" at March 31, 2006.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in the quantitative and qualitative disclosures about market risks as of March 31, 2006 from that presented in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

Item 4. Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act.

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

In the opinion of management, the Company is not involved in any pending legal proceedings other than routine, non-material proceedings occuring in the ordinary course of business.

Item 1A. Risk Factors

There are no material changes from the risk factors as previously disclosed in the Company's Form 10-K in response to Item 1A. to Part I to Form 10-K, filed with the Securities and Exchange Commission on March 24, 2006.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased		Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs		Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
January 1 - 31, 2006	-		-	-		2,000,000
February 1 - 28, 2006	509	(1)	23.83	-		2,000,000
March 1 - 31, 2006	17,500		24.29	17,500	(2)	1,575,000
Total	**18,009**		**24.27**	**17,500**		**1,575,000**

(1) The Company purchased 509 shares on the open market in February 2006 for its deferred compensation plan.

(2) The Company purchased 17,500 shares in March 2006, pursuant to a $2.0 million stock repurchase program which was announced on November 22, 2005. This program will expire November 30, 2006.

Item 3. Defaults Upon Senior Securities

Not applicable

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable

Item 5. Other Information

Not applicable

Item 6. Exhibits

Exhibit (3)(i)	Articles of Incorporation of Peoples Bancorp of North Carolina, Inc., incorporated by reference to Exhibit (3)(i) to the Form 8-A filed with the Securities and Exchange Commission on September 2, 1999
Exhibit (3)(ii)	Amended and Restated Bylaws of Peoples Bancorp of North Carolina, Inc., incorporated by reference to Exhibit (3)(ii) to the Form 10-K filed with the Securities and Exchange Commission on March 26, 2004
Exhibit (4)	Specimen Stock Certificate, incorporated by reference to Exhibit (4) to the Form 8-A filed with the Securities and Exchange Commission on September 2, 1999
Exhibit (10)(a)	Employment Agreement between Peoples Bank and Tony W. Wolfe incorporated by reference to Exhibit (10)(a) to the Form 10-K filed with the Securities and Exchange Commission on March 30, 2000
Exhibit (10)(b)	Employment Agreement between Peoples Bank and Joseph F. Beaman, Jr. incorporated by reference to Exhibit (10)(b) to the Form 10-K filed with the Securities and Exchange Commission on March 30, 2000
Exhibit (10)(c)	Employment Agreement between Peoples Bank and William D. Cable incorporated by reference to Exhibit (10)(d) to the Form 10-K filed with the Securities and Exchange Commission on March 30, 2000
Exhibit (10)(d)	Employment Agreement between Peoples Bank and Lance A. Sellers incorporated by reference to Exhibit (10)(e) to the Form 10-K filed with the Securities and Exchange Commission on March 30, 2000
Exhibit (10)(e)	Peoples Bancorp of North Carolina, Inc. Omnibus Stock Ownership and Long Term Incentive Plan incorporated by reference to Exhibit (10)(f) to the Form 10-K filed with the Securities and Exchange Commission on March 30, 2000

Exhibit (10)(f)	Employment Agreement between Peoples Bank and A. Joseph Lampron incorporated by reference to Exhibit (10)(g) to the Form 10-K filed with the Securities and Exchange Commission on March 28, 2002
Exhibit (10)(g)	Peoples Bank Directors' and Officers' Deferral Plan, incorporated by reference to Exhibit (10)(h) to the Form 10-K filed with the Securities and Exchange Commission on March 28, 2002
Exhibit (10)(h)	Rabbi Trust for the Peoples Bank Directors' and Officers' Deferral Plan, incorporated by reference to Exhibit (10)(i) to the Form 10-K filed with the Securities and Exchange Commission on March 28, 2002
Exhibit (10)(i)	Description of Service Recognition Program maintained by Peoples Bank, incorporated by reference to Exhibit (10)(i) to the Form 10-K filed with the Securities and Exchange Commission on March 27, 2003
Exhibit (14)	Code of Business Conduct and Ethics of Peoples Bancorp of North Carolina, Inc., incorporated by reference to Exhibit (14) to the Form 10-K filed with the Securities and Exchange Commission on March 25, 2005
Exhibit (31)(a)	Certification of principal executive officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002
Exhibit (31)(b)	Certification of principal financial officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002
Exhibit (32)	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Peoples Bancorp of North Carolina, Inc.

May 11, 2006 Date	/s/ Tony W. Wolfe Tony W. Wolfe President and Chief Executive Officer (Principal Executive Officer)
May 11, 2006 Date	/s/ A. Joseph Lampron A. Joseph Lampron Executive Vice President and Chief Financial Officer (Principal Financial and Principal Accounting Officer)

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