

CAPITAL CITY BANK GROUP INC  
Form 10-Q  
August 05, 2016

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the Quarterly Period Ended June 30, 2016**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number: 0-13358**

(Exact name of registrant as specified in its charter)

**Florida**

**59-2273542**

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(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

**217 North Monroe Street, Tallahassee, Florida**  
(Address of principal executive office)

**32301**  
(Zip Code)

**(850) 402-7000**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer       Accelerated filer       Non-accelerated filer       Smaller reporting company   
(Do not check if smaller reporting company)

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

At July 31, 2016, 16,803,602 shares of the Registrant's Common Stock, \$.01 par value, were outstanding.

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**CAPITAL CITY BANK GROUP, INC.**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE PERIOD ENDED JUNE 30, 2016**

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**Signatures**

## INTRODUCTORY NOTE

### Caution Concerning Forward-Looking Statements

This Quarterly Report on Form 10-Q contains “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, among others, statements about our beliefs, plans, objectives, goals, expectations, estimates and intentions that are subject to significant risks and uncertainties and are subject to change based on various factors, many of which are beyond our control. The words “may,” “could,” “should,” “would,” “believe,” “anticipate,” “estimate,” “expect,” “intend,” “plan,” “target,” “goal,” and similar expressions are used to identify forward-looking statements.

All forward-looking statements, by their nature, are subject to risks and uncertainties. Our actual future results may differ materially from those set forth in our forward-looking statements.

Our ability to achieve our financial objectives could be adversely affected by the factors discussed in detail in Part I, Item 2. “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and Part II, Item 1A. “Risk Factors” in this Quarterly Report on Form 10-Q and the following sections of our Annual Report on Form 10-K for the year ended December 31, 2015 (the “2015 Form 10-K”): (a) “Introductory Note” in Part I, Item 1. “Business”; (b) “Risk Factors” in Part I, Item 1A, as updated in our subsequent quarterly reports filed on Form 10-Q; and (c) “Introduction” in “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” in Part II, Item 7, as well as:

- our ability to successfully manage interest rate risk, liquidity risk, and other risks inherent to our industry;
- legislative or regulatory changes, including the Dodd-Frank Act, Basel III, and the ability to repay and qualified mortgage standards;
- the effects of security breaches and computer viruses that may affect our computer systems or fraud related to debit card products;
- the accuracy of our financial statement estimates and assumptions, including the estimates used for our loan loss provision and deferred tax asset valuation;
- the frequency and magnitude of foreclosure of our loans;
- the effects of our lack of a diversified loan portfolio, including the risks of geographic and industry concentrations;
- the strength of the United States economy in general and the strength of the local economies in which we conduct operations;
- our ability to declare and pay dividends, the payment of which is now subject to our compliance with heightened capital requirements;

- changes in the securities and real estate markets;
- changes in monetary and fiscal policies of the U.S. Government;
- inflation, interest rate, market and monetary fluctuations;
- the effects of harsh weather conditions, including hurricanes, and man-made disasters;
- our ability to comply with the extensive laws and regulations to which we are subject, including the laws for each jurisdiction where we operate;
- the willingness of clients to accept third-party products and services rather than our products and services and vice versa;
- increased competition and its effect on pricing;
- technological changes;
- negative publicity and the impact on our reputation;
- changes in consumer spending and saving habits;
- growth and profitability of our noninterest income;
- changes in accounting principles, policies, practices or guidelines;
- the limited trading activity of our common stock;
- the concentration of ownership of our common stock;
- anti-takeover provisions under federal and state law as well as our Articles of Incorporation and our Bylaws;
- other risks described from time to time in our filings with the Securities and Exchange Commission; and
- our ability to manage the risks involved in the foregoing.

However, other factors besides those listed in *Item 1A Risk Factors* or discussed in this Form 10-Q also could adversely affect our results, and you should not consider any such list of factors to be a complete set of all potential risks or uncertainties. Any forward-looking statements made by us or on our behalf speak only as of the date they are made. We do not undertake to update any forward-looking statement, except as required by applicable law.

**PART I. FINANCIAL INFORMATION****Item 1.**

**CAPITAL CITY BANK GROUP, INC.**  
**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

<i>(Dollars in Thousands)</i>	<b>(Unaudited)</b> <b>June 30,</b> <b>2016</b>	<b>December 31,</b> <b>2015</b>
<b>ASSETS</b>		
Cash and Due From Banks	\$ 51,766	\$ 51,288
Federal Funds Sold and Interest Bearing Deposits	220,719	327,617
Total Cash and Cash Equivalents	272,485	378,905
Investment Securities, Available for Sale, at fair value	485,848	451,028
Investment Securities, Held to Maturity, at amortized cost (fair value of \$205,595 and \$187,407)	204,474	187,892
Total Investment Securities	690,322	638,920
Loans Held For Sale	12,046	11,632
Loans, Net of Unearned Income	1,520,474	1,492,275
Allowance for Loan Losses	(13,677)	(13,953)
Loans, Net	1,506,797	1,478,322
Premises and Equipment, Net	97,313	98,819
Goodwill	84,811	84,811
Other Real Estate Owned	14,622	19,290
Other Assets	89,240	87,161
Total Assets	\$ 2,767,636	\$ 2,797,860
<b>LIABILITIES</b>		
Deposits:		
Noninterest Bearing Deposits	\$ 798,219	\$ 758,283
Interest Bearing Deposits	1,526,587	1,544,566
Total Deposits	2,324,806	2,302,849
Short-Term Borrowings	9,609	61,058
Subordinated Notes Payable	52,887	62,887
Other Long-Term Borrowings	26,401	28,265
Other Liabilities	79,109	68,449
Total Liabilities	2,492,812	2,523,508
<b>SHAREOWNERS' EQUITY</b>		
Preferred Stock, \$.01 par value; 3,000,000 shares authorized; no shares issued and outstanding	-	-
Common Stock, \$.01 par value; 90,000,000 shares authorized; 16,803,599 and 17,156,919 shares	168	172

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issued and outstanding at June 30, 2016 and December 31, 2015  
respectively

Additional Paid-In Capital	32,855	38,256
Retained Earnings	262,380	258,181
Accumulated Other Comprehensive Loss, Net of Tax	(20,579)	(22,257)
Total Shareowners' Equity	274,824	274,352
Total Liabilities and Shareowners' Equity	\$ 2,767,636	\$ 2,797,860

*The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.*

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**CAPITAL CITY BANK GROUP, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(Unaudited)

<i>(Dollars in Thousands, Except Per Share Data)</i>	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
<b>INTEREST INCOME</b>				
Loans, including Fees	\$ 18,105	\$ 18,231	\$ 36,150	\$ 36,094
Investment Securities:				
Taxable	1,539	1,313	2,959	2,511
Tax Exempt	212	138	429	234
Federal Funds Sold and Interest Bearing Deposits	318	151	680	340
Total Interest Income	20,174	19,833	40,218	39,179
<b>INTEREST EXPENSE</b>				
Deposits	211	259	432	505
Short-Term Borrowings	38	15	48	36
Subordinated Notes Payable	343	338	730	670
Other Long-Term Borrowings	206	237	422	477
Total Interest Expense	798	849	1,632	1,688
<b>NET INTEREST INCOME</b>	19,376	18,984	38,586	37,491
Provision for Loan Losses	(97)	375	355	668
Net Interest Income After Provision For Loan Losses	19,473	18,609	38,231	36,823
<b>NONINTEREST INCOME</b>				
Deposit Fees	5,321	5,682	10,721	11,223
Bank Card Fees	2,855	2,844	5,708	5,586
Wealth Management Fees	1,690	1,776	3,482	3,822
Mortgage Banking Fees	1,267	1,203	2,297	2,190
Data Processing Fees	335	364	682	737
Other	3,747	2,925	5,002	4,084
Total Noninterest Income	15,215	14,794	27,892	27,642
<b>NONINTEREST EXPENSE</b>				
Compensation	16,051	16,404	32,292	32,928
Occupancy, net	4,584	4,258	9,043	8,654
Other Real Estate Owned, net	1,060	931	2,485	2,428
Other	7,007	6,846	13,812	13,819
Total Noninterest Expense	28,702	28,439	57,632	57,829
<b>INCOME BEFORE INCOME TAXES</b>	5,986	4,964	8,491	6,636
Income Tax Expense	2,056	1,119	2,914	1,805
<b>NET INCOME</b>	<b>\$ 3,930</b>	<b>\$ 3,845</b>	<b>\$ 5,577</b>	<b>\$ 4,831</b>

<b>BASIC NET INCOME PER SHARE</b>	<b>\$ 0.22</b>	<b>\$ 0.22</b>	<b>\$ 0.32</b>	<b>\$ 0.28</b>
<b>DILUTED NET INCOME PER SHARE</b>	<b>\$ 0.22</b>	<b>\$ 0.22</b>	<b>\$ 0.32</b>	<b>\$ 0.28</b>
Average Common Basic Shares Outstanding	17,144	17,296	17,173	17,402
Average Common Diluted Shares Outstanding	17,196	17,358	17,215	17,456

*The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.*

**CAPITAL CITY BANK GROUP, INC.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(Unaudited)

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
<i>(Dollars in Thousands)</i>	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
<b>NET INCOME</b>	\$ 3,930	\$ 3,845	\$ 5,577	\$ 4,831
<b>Other comprehensive income (loss), before tax:</b>				
Investment Securities:				
Change in net unrealized gain/loss on securities available for sale	908	(117)	2,692	1,029
Amortization of unrealized losses on securities transferred from				
available for sale to held to maturity	20	19	39	36
Total Investment Securities	928	(98)	2,731	1,065
<b>Other comprehensive income (loss), before tax</b>	928	(98)	2,731	1,065
Deferred tax expense (benefit) related to other comprehensive income	358	(37)	1,053	411
<b>Other comprehensive income (loss), net of tax</b>	570	(61)	1,678	654
<b>TOTAL COMPREHENSIVE INCOME</b>	\$ 4,500	\$ 3,784	\$ 7,255	\$ 5,485

*The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.*

**CAPITAL CITY BANK GROUP, INC.**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREOWNERS' EQUITY**  
**(Unaudited)**

	Shares	Common	Additional	Retained	Accumulated Other Comprehensive Loss, Net of	
	Outstanding	Stock	Paid-In Capital	Earnings	Taxes	Total
<i>(Dollars In Thousands, Except Share Data)</i>						
<b>Balance, January 1, 2015</b>	17,447,223	\$ 174	\$ 42,569	\$ 251,306	\$ (21,509)	\$ 272,540
Net Income	-	-	-	4,831	-	4,831
Other Comprehensive Income, Net of Tax	-	-	-	-	654	654
Cash Dividends (\$0.0600 per share)	-	-	-	(1,041)	-	(1,041)
Repurchase of Common Stock	(392,981)	(3)	(5,795)	-	-	(5,798)
Stock Based Compensation	-	-	522	-	-	522
Impact of Transactions Under Compensation Plans, net	99,991	1	329	-	-	330
<b>Balance, June 30, 2015</b>	17,154,233	\$ 172	\$ 37,625	\$ 255,096	\$ (20,855)	\$ 272,038
<b>Balance, January 1, 2016</b>	17,156,919	\$ 172	\$ 38,256	\$ 258,181	\$ (22,257)	\$ 274,352
Net Income	-	-	-	5,577	-	5,577
Other Comprehensive Income, Net of Tax	-	-	-	-	1,678	1,678
Cash Dividends (\$0.0800 per share)	-	-	-	(1,378)	-	(1,378)
Repurchase of Common Stock	(435,461)	(4)	(6,308)	-	-	(6,312)
Stock Based Compensation	-	-	495	-	-	495
Impact of Transactions Under Compensation Plans, net	82,141	-	412	-	-	412
<b>Balance, June 30, 2016</b>	16,803,599	\$ 168	\$ 32,855	\$ 262,380	\$ (20,579)	\$ 274,824

*The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.*

**CAPITAL CITY BANK GROUP, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)

<i>(Dollars in Thousands)</i>	<b>Six Months Ended June 30,</b>	
	<b>2016</b>	<b>2015</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net Income	\$ 5,577	\$ 4,831
Adjustments to Reconcile Net Income to Cash Provided by Operating Activities:		
Provision for Loan Losses	355	668
Depreciation	3,435	3,259
Amortization of Premiums, Discounts, and Fees, net	3,037	2,269
Impairment Loss on Security	-	90
Gain on Retirement of Trust Preferred Securities	(2,487)	-
Net Increase in Loans Held-for-Sale	(414)	(303)
Stock Compensation	495	522
Deferred Income Taxes	3,586	2,591
Loss on Sales and Write-Downs of Other Real Estate Owned	1,980	1,309
Loss on Disposal of Premises and Equipment	92	20
Net (Increase) Decrease in Other Assets	(6,679)	1,043
Net Increase in Other Liabilities	10,787	6,768
Net Cash Provided By Operating Activities	19,764	23,067
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Securities Held to Maturity:		
Purchases	(28,588)	(62,634)
Payments, Maturities, and Calls	11,513	23,782
Securities Available for Sale:		
Purchases	(90,322)	(136,542)
Payments, Maturities, and Calls	55,619	43,417
Net Increase in Loans	(31,218)	(48,409)
Proceeds From Sales of Other Real Estate Owned	5,107	6,760
Purchases of Premises and Equipment	(2,021)	(1,641)
Net Cash Used In Investing Activities	(79,910)	(175,267)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net Increase in Deposits	21,957	17,850
Net (Decrease) Increase in Short-Term Borrowings	(51,886)	4,273
Redemption of Subordinated Notes	(7,500)	-
Repayment of Other Long-Term Borrowings	(1,427)	(1,364)
Dividends Paid	(1,378)	(1,041)
Payments to Repurchase Common Stock	(6,312)	(5,798)
Issuance of Common Stock Under Compensation Plans	272	280
Net Cash (Used In) Provided By Financing Activities	(46,274)	14,200
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(106,420)</b>	<b>(138,000)</b>
Cash and Cash Equivalents at Beginning of Period	378,905	385,056

Cash and Cash Equivalents at End of Period	\$	272,485	\$	247,056
<b>Supplemental Cash Flow Disclosures:</b>				
Interest Paid	\$	1,630	\$	1,694
Income Taxes (Refunded) Paid	\$	(375)	\$	171
<b>Noncash Investing and Financing Activities:</b>				
Loans Transferred to Other Real Estate Owned	\$	2,419	\$	2,830
Transfer of Current Portion of Long-Term Borrowings	\$	437	\$	-

*The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.*

**CAPITAL CITY BANK GROUP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES**

*Nature of Operations.* Capital City Bank Group, Inc. (“CCBG” or the “Company”) provides a full range of banking and banking-related services to individual and corporate clients through its subsidiary, Capital City Bank, with banking offices located in Florida, Georgia, and Alabama. The Company is subject to competition from other financial institutions, is subject to regulation by certain government agencies and undergoes periodic examinations by those regulatory authorities.

*Basis of Presentation.* The consolidated financial statements in this Quarterly Report on Form 10-Q include the accounts of CCBG and its wholly-owned subsidiary, Capital City Bank (“CCB” or the “Bank” and together with the Company). All material inter-company transactions and accounts have been eliminated.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included.

The consolidated statement of financial condition at December 31, 2015 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company’s annual report on Form 10-K for the year ended December 31, 2015.

**NOTE 2 – INVESTMENT SECURITIES**

*Investment Portfolio Composition.* The amortized cost and related market value of investment securities available-for-sale and held-to-maturity were as follows:

	<b>June 30, 2016</b>				<b>December 31, 2015</b>			
	Amortized	Unrealized	Unrealized	Market	Amortized	Unrealized	Unrealized	Market
	Cost	Gains	Losses	Value	Cost	Gain	Losses	Value
<b>Available for Sale</b>								

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U.S. Government Treasury	\$272,847	\$ 1,672	\$ 1	\$274,518	\$250,458	\$ 101	\$ 213	\$250,346
U.S. Government Agency	112,386	618	86	112,918	101,730	357	263	101,824
States and Political Subdivisions	87,391	498	2	87,887	88,358	103	99	88,362
Mortgage-Backed Securities	1,385	139	-	1,524	1,742	159	-	1,901
Equity Securities <sup>(1)</sup>	9,001	-	-	9,001	8,595	-	-	8,595
Total	\$483,010	\$ 2,927	\$ 89	\$485,848	\$450,883	\$ 720	\$ 575	\$451,028

**Held to Maturity**

U.S. Government Treasury	\$144,453	\$ 890	\$ -	\$145,343	\$134,554	\$ 45	\$ 160	\$134,439
U.S. Government Agency	8,010	8	-	8,018	10,043	7	5	10,045
States and Political Subdivisions	11,384	110	-	11,494	15,693	38	7	15,724
Mortgage-Backed Securities	40,627	207	94	40,740	27,602	4	407	27,199
Total	\$204,474	\$ 1,215	\$ 94	\$205,595	\$187,892	\$ 94	\$ 579	\$187,407

Total Investment Securities      \$687,484    \$ 4,142    \$ 183    \$691,443    \$638,775    \$ 814    \$ 1,154    \$638,435

<sup>(1)</sup> Includes Federal Home Loan Bank, Federal Reserve Bank, and FNBB, Inc. stock recorded at cost of \$3.7 million, \$4.8 million, and \$0.5 million, respectively, at June 30, 2016 and \$3.6 million, \$4.8 million, and \$0.2 million, respectively, at December 31, 2015.

Securities with an amortized cost of \$245.3 million and \$370.1 million at June 30, 2016 and December 31, 2015, respectively, were pledged to secure public deposits and for other purposes.



The Bank, as a member of the Federal Home Loan Bank of Atlanta (“FHLB”), is required to own capital stock in the FHLB based generally upon the balances of residential and commercial real estate loans, and FHLB advances. FHLB stock which is included in equity securities is pledged to secure FHLB advances. No ready market exists for this stock, and it has no quoted market value; however, redemption of this stock has historically been at par value.

*Maturity Distribution.* As of June 30, 2016, the Company's investment securities had the following maturity distribution based on contractual maturity. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations. Mortgage-backed securities and certain amortizing U.S. government agency securities are shown separately because they are not due at a certain maturity date.

<i>(Dollars in Thousands)</i>	<b>Available for Sale</b>		<b>Held to Maturity</b>	
	Amortized Cost	Market Value	Amortized Cost	Market Value
Due in one year or less	\$ 107,601	\$ 107,815	\$ 82,698	\$ 82,851
Due after one through five years	283,434	285,559	81,149	82,004
Mortgage-Backed Securities	1,385	1,524	40,627	40,740
U.S. Government Agency	81,589	81,949	-	-
Equity Securities	9,001	9,001	-	-
<b>Total</b>	<b>\$ 483,010</b>	<b>\$ 485,848</b>	<b>\$ 204,474</b>	<b>\$ 205,595</b>

*Unrealized Losses on Investment Securities.* The following table summarizes the investment securities with unrealized losses aggregated by major security type and length of time in a continuous unrealized loss position:

<i>(Dollars in Thousands)</i>	Less Than 12 Months		Greater Than 12 Months		Total	
	Market Value	Unrealized Losses	Market Value	Unrealized Losses	Market Value	Unrealized Losses
<b>June 30, 2016</b>						
<b>Available for Sale</b>						
U.S. Government Treasury	\$ 9,955	\$ 1	\$ -	\$ -	\$ 9,955	\$ 1
U.S. Government Agency	13,815	52	10,505	34	24,320	86
States and Political Subdivisions	3,135	2	302	-	3,437	2
<b>Total</b>	<b>26,905</b>	<b>55</b>	<b>10,807</b>	<b>34</b>	<b>37,712</b>	<b>89</b>
<b>Held to Maturity</b>						
Mortgage-Backed Securities	1,189	1	8,006	93	9,195	94
<b>Total</b>	<b>\$ 1,189</b>	<b>\$ 1</b>	<b>\$ 8,006</b>	<b>\$ 93</b>	<b>\$ 9,195</b>	<b>\$ 94</b>
<b>December 31, 2015</b>						
<b>Available for Sale</b>						
U.S. Government Treasury	\$ 150,061	\$ 213	\$ -	\$ -	\$ 150,061	\$ 213
U.S. Government Agency	43,508	200	9,644	63	53,152	263

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States and Political Subdivisions	39,608	86	5,066	13	44,674	99
Total	233,177	499	14,710	76	247,887	575

**Held to Maturity**

U.S. Government Treasury	92,339	160	-	-	92,339	160
U.S. Government Agency	5,006	5	-	-	5,006	5
States and Political Subdivisions	3,791	7	-	-	3,791	7
Mortgage-Backed Securities	13,267	185	11,889	222	22,156	407
Total	\$ 114,403	\$ 357	\$ 11,889	\$ 222	\$ 126,292	\$ 579

Management evaluates securities for other than temporary impairment at least quarterly, and more frequently when economic or market concerns warrant such evaluation. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, the Company considers, (i) whether it has decided to sell the security, (ii) whether it is more likely than not that the Company will have to sell the security before its market value recovers, and (iii) whether the present value of expected cash flows is sufficient to recover the entire amortized cost basis. When assessing a security's expected cash flows, the Company considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost and (ii) the financial condition and near-term prospects of the issuer. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by rating agencies have occurred, regulatory issues, and analysts' reports.

At June 30, 2016, there were 79 positions (combined Available-for-Sale and Held-to-Maturity) with unrealized losses totaling \$0.2 million. Of the 79 positions, 66 were Ginnie Mae mortgage-backed securities (GNMA), U.S. Treasuries, or SBA securities, all of which carry the full faith and credit guarantee of the U.S. Government. SBA securities float monthly or quarterly to the prime rate and are uncapped. Of these 66 positions, there were 21 GNMA positions and 26 SBA positions in an unrealized loss position for longer than 12 months. There were 13 municipal bonds in an unrealized loss position that were pre-refunded, or rated "AA-" or better. These debt securities are in a loss position because they were acquired when the general level of interest rates was lower than that on June 30, 2016. The Company believes that the unrealized losses in these debt securities are temporary in nature and that the full principal will be collected as anticipated. Because the declines in the market value of these investments are attributable to changes in interest rates and not credit quality and because the Company has the present ability and intent to hold these investments until there is a recovery in fair value, which may be at maturity, the Company does not consider these investments to be other-than-temporarily impaired at June 30, 2016.

### NOTE 3 – LOANS, NET

*Loan Portfolio Composition.* The composition of the loan portfolio was as follows:

<i>(Dollars in Thousands)</i>	<b>June 30, 2016</b>	<b>December 31, 2015</b>
Commercial, Financial and Agricultural	\$ 207,105	\$ 179,816
Real Estate – Construction	46,930	46,484
Real Estate – Commercial Mortgage	485,329	499,813
Real Estate – Residential <sup>1)</sup>	291,192	290,585
Real Estate – Home Equity	235,394	233,901
Consumer	254,524	241,676
Loans, Net of Unearned Income	\$ 1,520,474	\$ 1,492,275

<sup>(1)</sup> *Includes loans in process with outstanding balances of \$11.6 million and \$8.5 million at June 30, 2016 and December 31, 2015, respectively.*

Net deferred costs included in loans were \$0.2 million at June 30, 2016 and net deferred fees included in loans were \$0.5 million at December 31, 2015.

The Company has pledged a blanket floating lien on all 1-4 family residential mortgage loans, commercial real estate mortgage loans, and home equity loans to support available borrowing capacity at the FHLB of Atlanta and has pledged a blanket floating lien on all consumer loans, commercial loans, and construction loans to support available borrowing capacity at the Federal Reserve Bank of Atlanta.

*Nonaccrual Loans.* Loans are generally placed on nonaccrual status if principal or interest payments become 90 days past due and/or management deems the collectability of the principal and/or interest to be doubtful. Loans are returned to accrual status when the principal and interest amounts contractually due are brought current or when future payments are reasonably assured.

The following table presents the recorded investment in nonaccrual loans and loans past due over 90 days and still on accrual by class of loans.

<i>(Dollars in Thousands)</i>	<b>June 30, 2016</b>		<b>December 31, 2015</b>	
	<b>Nonaccrual</b>	<b>90 + Days</b>	<b>Nonaccrual</b>	<b>90 + Days</b>
Commercial, Financial and Agricultural	\$ 163	\$ -	\$ 96	\$ -
Real Estate – Construction	123	-	97	-
Real Estate – Commercial Mortgage	4,308	-	4,191	-
Real Estate – Residential	2,701	-	4,739	-
Real Estate – Home Equity	864	-	1,017	-
Consumer	55	-	165	-
<b>Total Nonaccrual Loans</b>	<b>\$ 8,214</b>	<b>\$ -</b>	<b>\$ 10,305</b>	<b>\$ -</b>

*Loan Portfolio Aging.* A loan is defined as a past due loan when one full payment is past due or a contractual maturity is over 30 days past due (“DPD”).

The following table presents the aging of the recorded investment in past due loans by class of loans.

<i>(Dollars in Thousands)</i>	<b>30-59 DPD</b>	<b>60-89 DPD</b>	<b>90 + DPD</b>	<b>Total Past Due</b>	<b>Total Current</b>	<b>Total Loans</b>
<b>June 30, 2016</b>						
Commercial, Financial and Agricultural	\$ 99	\$ 197	\$ -	\$ 296	\$ 206,646	\$ 207,105
Real Estate – Construction	-	-	-	-	46,807	46,930
Real Estate – Commercial Mortgage	679	161	-	840	480,181	485,329
Real Estate – Residential	565	438	-	1,003	287,488	291,192
Real Estate – Home Equity	424	46	-	470	234,060	235,394
Consumer	997	266	-	1,263	253,206	254,524
<b>Total Past Due Loans</b>	<b>\$ 2,764</b>	<b>\$ 1,108</b>	<b>\$ -</b>	<b>\$ 3,872</b>	<b>\$ 1,508,388</b>	<b>\$ 1,520,474</b>
<b>December 31, 2015</b>						
Commercial, Financial and Agricultural	\$ 153	\$ 18	\$ -	\$ 171	\$ 179,549	\$ 179,816
Real Estate – Construction	690	-	-	690	45,697	46,484
Real Estate – Commercial Mortgage	754	1,229	-	1,983	493,639	499,813
Real Estate – Residential	567	347	-	914	284,932	290,585
Real Estate – Home Equity	787	97	-	884	232,000	233,901

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Consumer	735	398	-	1,133	240,378	241,676
Total Past Due Loans	\$ 3,686	\$ 2,089	\$ -	\$ 5,775	\$ 1,476,195	\$ 1,492,275

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*Allowance for Loan Losses.* The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of incurred losses within the existing portfolio of loans. Loans are charged-off to the allowance when losses are deemed to be probable and reasonably quantifiable.

The following table details the activity in the allowance for loan losses by portfolio class. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

	Commercial,		Real Estate		Real Estate Home Equity	Consumer	Total
	Financial,	Real Estate	Commercial	Real Estate			
(Dollars in Thousands)	Agriculture	Construction	Mortgage	Residential			
<b>Three Months Ended</b>							
<b>June 30, 2016</b>							
Beginning Balance	\$ 883	\$ 101	\$ 4,349	\$ 4,137	\$ 2,435	\$ 1,708	\$ 13,613
Provision for Loan Losses	420	25	(197)	(676)	21	310	(97)
Charge-Offs	(304)	-	-	(205)	(146)	(438)	(1,093)
Recoveries	49	-	237	579	81	308	1,254
Net Charge-Offs	(255)	-	237	374	(65)	(130)	161
Ending Balance	\$ 1,048	\$ 126	\$ 4,389	\$ 3,835	\$ 2,391	\$ 1,888	\$ 13,677
<b>Six Months Ended</b>							
<b>June 30, 2016</b>							
Beginning Balance	\$ 905	\$ 101	\$ 4,498	\$ 4,409	\$ 2,473	\$ 1,567	\$ 13,953
Provision for Loan Losses	396	25	(153)	(706)	139	654	355
Charge-Offs	(341)	-	(274)	(683)	(361)	(877)	(2,536)
Recoveries	88	-	318	815	140	544	1,905
Net Charge-Offs	(253)	-	44	132	(221)	(333)	(631)
Ending Balance	\$ 1,048	\$ 126	\$ 4,389	\$ 3,835	\$ 2,391	\$ 1,888	\$ 13,677
<b>Three Months Ended</b>							
<b>June 30, 2015</b>							
Beginning Balance	\$ 903	\$ 574	\$ 4,501	\$ 6,195	\$ 2,547	\$ 1,370	\$ 16,090
Provision for Loan Losses	171	(214)	5	(257)	410	260	375
Charge-Offs	(239)	-	(285)	(484)	(454)	(351)	(1,813)
Recoveries	82	-	54	200	33	215	584
Net Charge-Offs	(157)	-	(231)	(284)	(421)	(136)	(1,229)
Ending Balance	\$ 917	\$ 360	\$ 4,275	\$ 5,654	\$ 2,536	\$ 1,494	\$ 15,236
<b>Six Months Ended</b>							
<b>June 30, 2015</b>							
Beginning Balance	\$ 784	\$ 843	\$ 5,287	\$ 6,520	\$ 2,882	\$ 1,223	\$ 17,539
Provision for Loan Losses	525	(483)	93	(325)	233	625	668
Charge-Offs	(529)	-	(1,189)	(789)	(636)	(927)	(4,070)

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Recoveries	137	-	84	248	57	573	1,099
Net Charge-Offs	(392)	-	(1,105)	(541)	(579)	(354)	(2,971)
Ending Balance	\$ 917	\$ 360	\$ 4,275	\$ 5,654	\$ 2,536	\$ 1,494	\$ 15,236



The following table details the amount of the allowance for loan losses by portfolio class disaggregated on the basis of the Company's impairment methodology.

	Commercial,		Real Estate		Real Estate		Real Estate		Total
	Financial,	Real Estate	Commercial	Real Estate	Real Estate	Real Estate	Consumer		
(Dollars in Thousands)	Agriculture	Construction	Mortgage	Residential	Home Equity	Consumer			
<b>June 30, 2016</b>									
Period-end amount									
Allocated to:									
Loans Individually									
Evaluated for Impairment	\$ 69	\$ -	\$ 1,953	\$ 1,868	\$ 318	\$ 9		\$ 4,217	
Loans Collectively									
Evaluated for Impairment	979	126	2,436	1,967	2,073	1,879		9,460	
Ending Balance	\$ 1,048	\$ 126	\$ 4,389	\$ 3,835	\$ 2,391	\$ 1,888		\$ 13,677	
<b>December 31, 2015</b>									
Period-end amount									
Allocated to:									
Loans Individually									
Evaluated for Impairment	\$ 77	\$ -	\$ 2,049	\$ 2,118	\$ 384	\$ 18		\$ 4,646	
Loans Collectively									
Evaluated for Impairment	828	101	2,449	2,291	2,089	1,549		9,307	
Ending Balance	\$ 905	\$ 101	\$ 4,498	\$ 4,409	\$ 2,473	\$ 1,567		\$ 13,953	
<b>June 30, 2015</b>									
Period-end amount									
Allocated to:									
Loans Individually									
Evaluated for Impairment	\$ 288	\$ -	\$ 2,070	\$ 1,980	\$ 453	\$ 12		\$ 4,803	
Loans Collectively									
Evaluated for Impairment	629	360	2,205	3,674	2,083	1,482		10,433	
Ending Balance	\$ 917	\$ 360	\$ 4,275	\$ 5,654	\$ 2,536	\$ 1,494		\$ 15,236	

The Company's recorded investment in loans related to each balance in the allowance for loan losses by portfolio class and disaggregated on the basis of the Company's impairment methodology was as follows:

<i>(Dollars in Thousands)</i>	<b>Commercial, Financial,</b>	<b>Real Estate</b>	<b>Real Estate</b>	<b>Real Estate</b>	<b>Real Estate</b>	<b>Real Estate</b>	<b>Total</b>
	<b>Agricultural</b>	<b>Construction</b>	<b>Commercial Mortgage</b>	<b>Real Estate Residential</b>	<b>Home Equity</b>	<b>Consumer</b>	
<b>June 30, 2016</b>							
Individually Evaluated for Impairment	\$ 793	\$ -	\$ 20,589	\$ 17,725	\$ 2,872	\$ 206	\$ 42,185
Collectively Evaluated for Impairment	206,312	46,930	464,740	273,467	232,522	254,318	1,478,289
Total	\$ 207,105	\$ 46,930	\$ 485,329	\$ 291,192	\$ 235,394	\$ 254,524	\$1,520,474
<b>December 31, 2015</b>							
Individually Evaluated for Impairment	\$ 834	\$ 97	\$ 20,847	\$ 18,569	\$ 3,144	\$ 261	\$ 43,752
Collectively Evaluated for Impairment	178,982	46,387	478,966	272,016	230,757	241,415	1,448,523
Total	\$ 179,816	\$ 46,484	\$ 499,813	\$ 290,585	\$ 233,901	\$ 241,676	\$1,492,275
<b>June 30, 2015</b>							
Individually Evaluated for Impairment	\$ 1,072	\$ 311	\$ 29,746	\$ 18,918	\$ 2,960	\$ 171	\$ 53,178
Collectively Evaluated for Impairment	150,044	43,905	481,216	277,463	227,428	241,031	1,421,087
Total	\$ 151,116	\$ 44,216	\$ 510,962	\$ 296,381	\$ 230,388	\$ 241,202	\$1,474,265

*Impaired Loans.* Loans are deemed to be impaired when, based on current information and events, it is probable that the Company will not be able to collect all amounts due (principal and interest payments), according to the contractual terms of the loan agreement. Loans, for which the terms have been modified, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

The following table presents loans individually evaluated for impairment by class of loans.

<i>(Dollars in Thousands)</i>	<b>Unpaid Principal Balance</b>	<b>Recorded Investment With No Allowance</b>	<b>Recorded Investment With Allowance</b>	<b>Related Allowance</b>
<b>June 30, 2016</b>				
Commercial, Financial and Agricultural	\$ 793	\$ 268	\$ 525	\$ 69
Real Estate – Construction	-	-	-	-
Real Estate – Commercial Mortgage	20,589	4,064	16,525	1,953
Real Estate – Residential	17,725	2,769	14,956	1,868
Real Estate – Home Equity	2,872	831	2,041	318
Consumer	206	45	161	9
Total	\$ 42,185	\$ 7,977	\$ 34,208	\$ 4,217
<b>December 31, 2015</b>				
Commercial, Financial and Agricultural	\$ 834	\$ 279	\$ 555	\$ 77
Real Estate – Construction	97	97	-	-
Real Estate – Commercial Mortgage	20,847	3,265	17,582	2,049
Real Estate – Residential	18,569	2,941	15,628	2,118
Real Estate – Home Equity	3,144	1,101	2,043	384
Consumer	261	79	182	18
Total	\$ 43,752	\$ 7,762	\$ 35,990	\$ 4,646

The following table summarizes the average recorded investment and interest income recognized by class of impaired loans.

	Three Months Ended June 30,				Six Months Ended June 30,			
	2016		2015		2016		2015	
	Average Recorded	Total Interest	Average Recorded	Total Interest	Average Recorded	Total Interest	Average Recorded	Total Interest
(Dollars in Thousands)	Investment	Income	Investment	Income	Investment	Income	Investment	Income
Commercial, Financial and Agricultural	\$ 802	\$ 12	\$ 1,162	\$ 11	\$ 813	\$ 25	\$ 1,121	\$ 22
Real Estate – Construction	-	-	356	-	32	-	371	-
Real Estate – Commercial Mortgage	20,694	216	30,480	310	20,745	455	31,067	571
Real Estate – Residential	17,973	196	19,379	214	18,172	405	19,626	411
Real Estate – Home Equity	3,042	29	3,042	23	3,076	56	3,053	43
Consumer	206	2	183	2	224	4	194	4
Total	\$ 42,717	\$ 455	\$ 54,602	\$ 560	\$ 43,062	\$ 945	\$ 55,432	\$ 1,051

*Credit Risk Management.* The Company has adopted comprehensive lending policies, underwriting standards and loan review procedures designed to maximize loan income within an acceptable level of risk. Management and the Board of Directors review and approve these policies and procedures on a regular basis (at least annually).

Reporting systems have been implemented to monitor loan originations, loan quality, concentrations of credit, loan delinquencies and nonperforming loans and potential problem loans. Management and the Credit Risk Oversight Committee periodically review our lines of business to monitor asset quality trends and the appropriateness of credit policies. In addition, total borrower exposure limits are established and concentration risk is monitored. As part of this process, the overall composition of the portfolio is reviewed to gauge diversification of risk, client concentrations, industry group, loan type, geographic area, or other relevant classifications of loans. Specific segments of the loan portfolio are monitored and reported to the Board on a quarterly basis and have strategic plans in place to supplement Board approved credit policies governing exposure limits and underwriting standards. Detailed below are the types of loans within the Company's loan portfolio and risk characteristics unique to each.

Commercial, Financial, and Agricultural – Loans in this category are primarily made based on identified cash flows of the borrower with consideration given to underlying collateral and personal or other guarantees. Lending policy establishes debt service coverage ratio limits that require a borrower's cash flow to be sufficient to cover principal and interest payments on all new and existing debt. The majority of these loans are secured by the assets being financed or other business assets such as accounts receivable, inventory, or equipment. Collateral values are determined based upon third party appraisals and evaluations. Loan to value ratios at origination are governed by established policy guidelines.

Real Estate Construction – Loans in this category consist of short-term construction loans, revolving and non-revolving credit lines and construction/permanent loans made to individuals and investors to finance the acquisition, development, construction or rehabilitation of real property. These loans are primarily made based on identified cash flows of the borrower or project and generally secured by the property being financed, including 1-4 family residential properties and commercial properties that are either owner-occupied or investment in nature. These properties may include either vacant or improved property. Construction loans are generally based upon estimates of costs and value associated with the completed project. Collateral values are determined based upon third party appraisals and evaluations. Loan to value ratios at origination are governed by established policy guidelines. The disbursement of funds for construction loans is made in relation to the progress of the project and as such these loans are closely monitored by on-site inspections.

Real Estate Commercial Mortgage – Loans in this category consists of commercial mortgage loans secured by property that is either owner-occupied or investment in nature. These loans are primarily made based on identified cash flows of the borrower or project with consideration given to underlying real estate collateral and personal guarantees. Lending policy establishes debt service coverage ratios and loan to value ratios specific to the property type. Collateral values are determined based upon third party appraisals and evaluations.

Real Estate Residential – Residential mortgage loans held in the Company’s loan portfolio are made to borrowers that demonstrate the ability to make scheduled payments with full consideration to underwriting factors such as current income, employment status, current assets, and other financial resources, credit history, and the value of the collateral. Collateral consists of mortgage liens on 1-4 family residential properties. Collateral values are determined based upon third party appraisals and evaluations. The Company does not originate sub-prime loans.

Real Estate Home Equity – Home equity loans and lines are made to qualified individuals for legitimate purposes generally secured by senior or junior mortgage liens on owner-occupied 1-4 family homes or vacation homes. Borrower qualifications include favorable credit history combined with supportive income and debt ratio requirements and combined loan to value ratios within established policy guidelines. Collateral values are determined based upon third party appraisals and evaluations.

Consumer Loans – This loan portfolio includes personal installment loans, direct and indirect automobile financing, and overdraft lines of credit. The majority of the consumer loan portfolio consists of indirect and direct automobile loans. Lending policy establishes maximum debt to income ratios, minimum credit scores, and includes guidelines for verification of applicants' income and receipt of credit reports.

*Credit Quality Indicators.* As part of the ongoing monitoring of the Company's loan portfolio quality, management categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment performance, credit documentation, and current economic/market trends, among other factors. Risk ratings are assigned to each loan and revised as needed through established monitoring procedures for individual loan relationships over a predetermined amount and review of smaller balance homogenous loan pools. The Company uses the definitions noted below for categorizing and managing its criticized loans. Loans categorized as "Pass" do not meet the criteria set forth for the Special Mention, Substandard, or Doubtful categories and are not considered criticized.

Special Mention – Loans in this category are presently protected from loss, but weaknesses are apparent which, if not corrected, could cause future problems. Loans in this category may not meet required underwriting criteria and have no mitigating factors. More than the ordinary amount of attention is warranted for these loans.

Substandard – Loans in this category exhibit well-defined weaknesses that would typically bring normal repayment into jeopardy. These loans are no longer adequately protected due to well-defined weaknesses that affect the repayment capacity of the borrower. The possibility of loss is much more evident and above average supervision is required for these loans.

Doubtful – Loans in this category have all the weaknesses inherent in a loan categorized as Substandard, with the characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

The following table presents the risk category of loans by segment.

<i>(Dollars in Thousands)</i>	<b>Commercial, Financial, Agriculture</b>	<b>Real Estate</b>	<b>Consumer</b>	<b>Total Criticized Loans</b>
<b>June 30, 2016</b>				
Special Mention	\$ 3,023	\$ 29,868	\$ 71	\$ 32,962
Substandard	1,553	42,952	553	45,058
Doubtful	-	-	-	-
Total Criticized Loans	\$ 4,576	\$ 72,820	\$ 624	\$ 78,020
<b>December 31, 2015</b>				
Special Mention	\$ 5,938	\$ 27,838	\$ 69	\$ 33,845
Substandard	1,307	51,425	819	53,551
Doubtful	-	-	-	-
Total Criticized Loans	\$ 7,245	\$ 79,263	\$ 888	\$ 87,396

*Troubled Debt Restructurings ("TDRs")*. TDRs are loans in which the borrower is experiencing financial difficulty and the Company has granted an economic concession to the borrower that it would not otherwise consider. In these instances, as part of a work-out alternative, the Company will make concessions including the extension of the loan term, a principal moratorium, a reduction in the interest rate, or a combination thereof. The impact of the TDR modifications and defaults are factored into the allowance for loan losses on a loan-by-loan basis as all TDRs are, by definition, impaired loans. Thus, specific reserves are established based upon the results of either a discounted cash flow analysis or the underlying collateral value, if the loan is deemed to be collateral dependent. In the limited circumstances that a loan is removed from TDR classification it is the Company's policy to also remove it from the impaired loan category, but to continue to individually evaluate loan impairment based on the contractual terms specified by the loan agreement.

The following table presents loans classified as TDRs.

<i>(Dollars in Thousands)</i>	<b>June 30, 2016</b>		<b>December 31, 2015</b>	
	<b>Accruing</b>	<b>Nonaccruing</b>	<b>Accruing</b>	<b>Nonaccruing</b>
Commercial, Financial and Agricultural	\$ 857	\$ -	\$ 897	\$ -
Real Estate – Construction	-	-	-	-
Real Estate – Commercial Mortgage	16,444	1,328	16,621	1,070
Real Estate – Residential	15,297	685	14,979	1,582
Real Estate – Home Equity	2,734	-	2,914	-
Consumer	194	-	223	35
Total TDRs	\$ 35,526	\$ 2,013	\$ 35,634	\$ 2,687

Loans classified as TDRs during the periods indicated are presented in the table below. The modifications made during the reporting period involved either an extension of the loan term, an interest rate adjustment, or a principal moratorium, and the financial impact of these modifications was not material.

<i>(Dollars in Thousands)</i>	<b>Three Months Ended June 30, 2016</b>			<b>Six Months Ended June 30, 2016</b>		
	Number of Contracts	Pre-Modified Recorded Investment	Post-Modified Recorded Investment	Number of Contracts	Pre-Modified Recorded Investment	Post-Modified Recorded Investment
Commercial, Financial and Agricultural	-	\$ -	\$ -	-	\$ -	\$ -
Real Estate – Construction	-	-	-	-	-	-
Real Estate – Commercial Mortgage	-	-	-	1	332	332
Real Estate – Residential	1	90	90	6	589	590
Real Estate – Home Equity	-	-	-	4	188	189
Consumer	-	-	-	-	-	-
Total TDRs	1	\$ 90	\$ 90	11	\$ 1,109	\$ 1,111

<i>(Dollars in Thousands)</i>	<b>Three Months Ended June 30, 2015</b>			<b>Six Months Ended June 30, 2015</b>		
	Number of Contracts	Pre-Modified Recorded Investment	Post-Modified Recorded Investment	Number of Contracts	Pre-Modified Recorded Investment	Post-Modified Recorded Investment
Commercial, Financial and Agricultural	-	\$ -	\$ -	-	\$ -	\$ -
Real Estate – Construction	-	-	-	-	-	-
Real Estate – Commercial Mortgage	1	58	58	2	515	515
Real Estate – Residential	1	204	204	5	668	641
Real Estate – Home Equity	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Total TDRs	2	\$ 262	\$ 262	7	\$ 1,183	\$ 1,156





For the three and six months ended June 30, 2016, loans modified as TDRs within the previous 12 months that have subsequently defaulted during the periods indicated are presented in the table below. For the three and six months ended June 30, 2015, there were no loans modified as TDRs within the previous 12 months that have subsequently defaulted.

	<b>Three Months Ended June 30, 2016</b>		<b>Six Months Ended June 30, 2016</b>	
	Number of Contracts	Post-Modified Recorded Investment <sup>(1)</sup>	Number of Contracts	Post-Modified Recorded Investment <sup>(1)</sup>
<i>(Dollars in Thousands)</i>				
Commercial, Financial and Agricultural	-	\$ -	-	\$ -
Real Estate – Construction	-	-	-	-
Real Estate – Commercial Mortgage	-	-	-	-
Real Estate – Residential	1	98	1	98
Real Estate – Home Equity	-	-	1	3
Consumer	-	-	1	35
Total TDRs	1	\$ 98	3	\$ 136

<sup>(1)</sup> Recorded investment reflects charge-offs and additional funds advanced at time of restructure, if applicable.

The following table provides information on how TDRs were modified during the periods indicated.

	<b>Three Months Ended June 30, 2016</b>		<b>Six Months Ended June 30, 2016</b>	
	Number of Contracts	Recorded Investment <sup>(1)</sup>	Number of Contracts	Recorded Investment <sup>(1)</sup>
<i>(Dollars in Thousands)</i>				
Extended amortization	1	\$ 90	1	\$ 90
Interest rate adjustment	-	-	-	-
Extended amortization and interest rate adjustment	-	-	10	1,021
Total TDRs	1	\$ 90	11	\$ 1,111

	<b>Three Months Ended June 30, 2015</b>		<b>Six Months Ended June 30, 2015</b>	
	Number of Contracts	Recorded Investment <sup>(1)</sup>	Number of Contracts	Recorded Investment <sup>(1)</sup>
<i>(Dollars in Thousands)</i>				
Extended amortization	-	\$ -	1	\$ 118
Interest rate adjustment	-	-	1	156
Extended amortization and interest rate adjustment	2	262	5	882
Total TDRs	2	\$ 262	7	\$ 1,156

(1) *Recorded investment reflects charge-offs and additional funds advanced at time of restructure, if applicable.*

#### NOTE 4 – OTHER REAL ESTATE OWNED

The following table presents other real estate owned activity for the periods indicated.

<i>(Dollars in Thousands)</i>	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Beginning Balance	\$ 17,450	\$ 33,835	\$ 19,290	\$ 35,680
Additions	1,218	1,088	2,419	2,830
Valuation Write-downs	(678)	(505)	(1,513)	(1,306)
Sales	(3,368)	(4,026)	(5,574)	(6,763)
Other	-	(225)	-	(274)
Ending Balance	\$ 14,622	\$ 30,167	\$ 14,622	\$ 30,167

Net expenses applicable to other real estate owned include the following:

<i>(Dollars in Thousands)</i>	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Gains from the Sale of Properties	\$ (166)	\$ (534)	\$ (294)	\$ (655)
Losses from the Sale of Properties	392	348	761	658
Rental Income from Properties	(32)	(43)	(32)	(231)
Property Carrying Costs	188	655	537	1,350
Valuation Adjustments	678	505	1,513	1,306
Total	\$ 1,060	\$ 931	\$ 2,485	\$ 2,428

As of June 30, 2016 the Company had \$1.9 million of loans secured by residential real estate in the process of foreclosure.

#### **NOTE 5 - EMPLOYEE BENEFIT PLANS**

The Company has a defined benefit pension plan covering substantially all full-time and eligible part-time associates and a Supplemental Executive Retirement Plan (“SERP”) covering its executive officers.

The components of the net periodic benefit cost for the Company's qualified benefit pension plan were as follows:

<i>(Dollars in Thousands)</i>	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Service Cost	\$ 1,613	\$ 1,675	\$ 3,226	\$ 3,350
Interest Cost	1,397	1,425	2,794	2,850
Expected Return on Plan Assets	(1,934)	(1,950)	(3,870)	(3,900)
Prior Service Cost Amortization	69	75	139	150
Net Loss Amortization	801	800	1,602	1,600
Net Periodic Benefit Cost	\$ 1,946	\$ 2,025	\$ 3,891	\$ 4,050
Discount Rate	4.52%	4.15%	4.52%	4.15%
Long-term Rate of Return on Assets	7.50%	7.50%	7.50%	7.50%

The components of the net periodic benefit cost (income) for the Company's SERP were as follows:

<i>(Dollars in Thousands)</i>	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Interest Cost	\$ 40	\$ 28	\$ 80	\$ 55

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Prior Service Cost Amortization	-	2	-	5
Net Loss (Gain) Amortization	190	(90)	380	(180)
Net Periodic Benefit Cost (Income)	\$ 230	\$ (60)	\$ 460	\$ (120)
Discount Rate	4.13%	4.15%	4.13%	4.15%

Effective December 31, 2015, the Company changed the method used to estimate the service and interest components of net periodic benefit cost for the defined benefit and supplemental executive retirement plans. This new estimation approach discounts the individual expected cash flows underlying the service cost and interest cost using the applicable spot rates derived from the yield curve used to discount the cash flows for the benefit obligations. Historically, the estimated service and interest cost components utilized a single weighted-average discount rate derived from the yield curve used to measure the benefit obligations at the beginning of the period. The Company elected this change to provide a more precise measurement of service and interest costs by improving the correlation between projected benefit cash flows to the corresponding spot yield curve rates. The change was accounted for as a change in accounting estimate that is inseparable from a change in accounting principle and was accounted for prospectively. While the benefit obligations for the plans measured under this approach was unchanged, the more granular application of the spot rates decreased the combined service and interest costs for the defined benefit retirement plan for fiscal 2016 by \$0.7 million and the supplemental executive retirement plans by \$34,000.

**NOTE 6 - COMMITMENTS AND CONTINGENCIES**

*Lending Commitments.* The Company is a party to financial instruments with off-balance sheet risks in the normal course of business to meet the financing needs of its clients. These financial instruments consist of commitments to extend credit and standby letters of credit.

The Company's maximum exposure to credit loss under standby letters of credit and commitments to extend credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in establishing commitments and issuing letters of credit as it does for on-balance sheet instruments. The amounts associated with the Company's off-balance sheet obligations were as follows:

<i>(Dollars in Thousands)</i>	<b>June 30, 2016</b>			<b>December 31, 2015</b>		
	<b>Fixed</b>	<b>Variable</b>	<b>Total</b>	<b>Fixed</b>	<b>Variable</b>	<b>Total</b>
Commitments to Extend Credit <sup>(1)</sup>	\$ 60,358	\$ 343,178	\$ 403,536	\$ 57,571	\$ 306,642	\$ 364,213
Standby Letters of Credit	6,075	-	6,075	6,095	-	6,095
Total	\$ 66,433	\$ 343,178	\$ 409,611	\$ 63,666	\$ 306,642	\$ 370,308

<sup>(1)</sup> *Commitments include unfunded loans, revolving lines of credit, and other unused commitments.*

Commitments to extend credit are agreements to lend to a client so long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a client to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities. In general, management does not anticipate any material losses as a result of participating in these types of transactions. However, any potential losses arising from such transactions are reserved for in the same manner as management reserves for its other credit facilities.

For both on- and off-balance sheet financial instruments, the Company requires collateral to support such instruments when it is deemed necessary. The Company evaluates each client's creditworthiness on a case-by-case basis. The amount of collateral obtained upon extension of credit is based on management's credit evaluation of the counterparty. Collateral held varies, but may include deposits held in financial institutions; U.S. Treasury securities; other marketable securities; real estate; accounts receivable; property, plant and equipment; and inventory.

*Contingencies.* The Company is a party to lawsuits and claims arising out of the normal course of business. In management's opinion, there are no known pending claims or litigation, the outcome of which would, individually or in the aggregate, have a material effect on the consolidated results of operations, financial position, or cash flows of the Company.

*Indemnification Obligation.* The Company is a member of the Visa U.S.A. network. Visa U.S.A member banks are required to indemnify it for potential future settlement of certain litigation (the "Covered Litigation") that relates to several antitrust lawsuits challenging the practices of Visa and MasterCard International. In 2008, the Company, as a member of the Visa U.S.A. network, obtained Class B shares of Visa, Inc. upon its initial public offering. Since its initial public offering, Visa, Inc. has funded a litigation reserve for the Covered Litigation resulting in a reduction in the Class B shares held by the Company. During the first quarter of 2011, the Company sold its remaining Class B shares resulting in a \$3.2 million pre-tax gain. Associated with this sale, the Company entered into a swap contract with the purchaser of the shares that requires a payment to the counterparty in the event that Visa, Inc. makes subsequent revisions to the conversion ratio for its Class B shares. Fixed charges included in the swap liability are payable quarterly until the litigation reserve is fully liquidated and at which time the aforementioned swap contract will be terminated. Quarterly fixed payments approximate \$65,000. Conversion ratio payments and ongoing fixed quarterly charges are reflected in earnings in the period incurred.

## NOTE 7 – FAIR VALUE MEASUREMENTS

The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for such asset or liability. In estimating fair value, the Company utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. ASC Topic 820 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

- *Level 1 Inputs* - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
- *Level 2 Inputs* - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from, or corroborated, by market data by correlation or other means.
- *Level 3 Inputs* - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

### Assets and Liabilities Measured at Fair Value on a Recurring Basis

*Securities Available for Sale.* U.S. Treasury securities and certain U.S. Government Agency securities are reported at fair value utilizing Level 1 inputs. Other securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, credit information and the bond's terms and conditions, among other things.

In general, the Company does not purchase securities that have a complicated structure. The Company's entire portfolio consists of traditional investments, nearly all of which are U.S. Treasury obligations, federal agency bullet or mortgage pass-through securities, or general obligation or revenue based municipal bonds. Pricing for such



instruments is easily obtained. From time to time, the Company will validate, on a sample basis, prices supplied by the independent pricing service by comparison to prices obtained from third-party sources or derived using internal models.

*Fair Value Swap.* The Company entered into a stand-alone derivative contract with the purchaser of its Visa Class B shares. The valuation represents the amount due and payable to the counterparty based upon the revised share conversion rate, if any, during the period. At June 30, 2016, there were not amounts payable.

A summary of fair values for assets and liabilities consisted of the following:

<i>(Dollars in Thousands)</i>	<b>Level 1 Inputs</b>	<b>Level 2 Inputs</b>	<b>Level 3 Inputs</b>	<b>Total Fair Value</b>
<b>June 30, 2016</b>				
Securities Available for Sale:				
U.S. Government Treasury	\$ 274,518	\$ -	\$ -	\$ 274,518
U.S. Government Agency	-	112,918	-	112,918
States and Political Subdivisions	-	87,887	-	87,887
Mortgage-Backed Securities	-	1,524	-	1,524
Equity Securities	-	9,001	-	9,001
<b>December 31, 2015</b>				
Securities Available for Sale:				
U.S. Government Treasury	\$ 250,346	\$ -	\$ -	\$ 250,346
U.S. Government Agency	-	101,824	-	101,824
States and Political Subdivisions	-	88,362	-	88,362
Mortgage-Backed Securities	-	1,901	-	1,901
Equity Securities	-	8,595	-	8,595

### **Assets Measured at Fair Value on a Non-Recurring Basis**

Certain assets are measured at fair value on a non-recurring basis (i.e., the assets are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances). An example would be assets exhibiting evidence of impairment. The following is a description of valuation methodologies used for assets measured on a non-recurring basis.

*Impaired Loans.* Impairment for collateral dependent loans is measured using the fair value of the collateral less selling costs. The fair value of collateral is determined by an independent valuation or professional appraisal in conformance with banking regulations. Collateral values are estimated using Level 3 inputs due to the volatility in the real estate market, and the judgment and estimation involved in the real estate appraisal process. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly. Valuation techniques are consistent with those techniques applied in prior periods. Impaired collateral dependent loans had a carrying value of \$6.6 million with a valuation allowance of \$0.5 million at June 30, 2016 and \$8.8 million and \$0.9 million, respectively, at December 31, 2015.

*Loans Held for Sale.* These loans are carried at the lower of cost or fair value and are adjusted to fair value on a non-recurring basis. Fair value is based on observable markets rates for comparable loan products, which is considered a Level 2 fair value measurement.

*Other Real Estate Owned.* During the first six months of 2016, certain foreclosed assets, upon initial recognition, were measured and reported at fair value through a charge-off to the allowance for loan losses based on the fair value of the foreclosed asset less estimated cost to sell. The fair value of the foreclosed asset is determined by an independent valuation or professional appraisal in conformance with banking regulations. On an ongoing basis, we obtain updated appraisals on foreclosed assets and realize valuation adjustments as necessary. The fair value of foreclosed assets is estimated using Level 3 inputs due to the judgment and estimation involved in the real estate valuation process.

### **Assets and Liabilities Disclosed at Fair Value**

The Company is required to disclose the estimated fair value of financial instruments, both assets and liabilities, for which it is practical to estimate fair value and the following is a description of valuation methodologies used for those assets and liabilities.

*Cash and Short-Term Investments.* The carrying amount of cash and short-term investments is used to approximate fair value, given the short time frame to maturity and as such assets do not present unanticipated credit concerns.

*Securities Held to Maturity.* Securities held to maturity are valued in accordance with the methodology previously noted in this footnote under the caption “Assets and Liabilities Measured at Fair Value on a Recurring Basis – Securities Available for Sale”.

*Loans.* The loan portfolio is segregated into categories and the fair value of each loan category is calculated using present value techniques based upon projected cash flows and estimated discount rates that reflect the credit, interest rate, and liquidity risks inherent in each loan category. The calculated present values are then reduced by an allocation of the allowance for loan losses against each respective loan category.

*Deposits.* The fair value of Noninterest Bearing Deposits, NOW Accounts, Money Market Accounts and Savings Accounts are the amounts payable on demand at the reporting date. The fair value of fixed maturity certificates of deposit is estimated using present value techniques and rates currently offered for deposits of similar remaining maturities.

*Subordinated Notes Payable.* The fair value of each note is calculated using present value techniques, based upon projected cash flows and estimated discount rates as well as rates being offered for similar obligations.

*Short-Term and Long-Term Borrowings.* The fair value of each note is calculated using present value techniques, based upon projected cash flows and estimated discount rates as well as rates being offered for similar debt.

A summary of estimated fair values of significant financial instruments consisted of the following:

<i>(Dollars in Thousands)</i>	<b>Carrying Value</b>	<b>June 30, 2016</b>		
		<b>Level 1 Inputs</b>	<b>Level 2 Inputs</b>	<b>Level 3 Inputs</b>
<b>ASSETS:</b>				
Cash	\$ 51,766	\$ 51,766	\$ -	\$ -
Short-Term Investments	220,719	220,719	-	-
Investment Securities, Available for Sale	485,848	274,518	211,330	-
Investment Securities, Held to Maturity	204,474	145,343	60,252	-
Loans Held for Sale	12,046	-	12,046	-
Loans, Net of Allowance for Loan Losses	1,506,797	-	-	1,517,528
<b>LIABILITIES:</b>				
Deposits	\$ 2,324,806	\$ -	\$ 2,322,123	\$ -
Short-Term Borrowings	9,609	-	9,623	-
Subordinated Notes Payable	52,887	-	41,433	-
Long-Term Borrowings	26,401	-	27,284	-

<i>(Dollars in Thousands)</i>	<b>Carrying Value</b>	<b>December 31, 2015</b>		
		<b>Level 1 Inputs</b>	<b>Level 2 Inputs</b>	<b>Level 3 Inputs</b>
<b>ASSETS:</b>				
Cash	\$ 51,288	\$ 51,288	\$ -	\$ -
Short-Term Investments	327,617	327,617	-	-
Investment Securities, Available for Sale	451,028	250,346	200,682	-
Investment Securities, Held to Maturity	187,892	134,439	52,968	-
Loans Held for Sale	11,632	-	11,632	-
Loans, Net of Allowance for Loan Losses	1,478,322	-	-	1,483,926
<b>LIABILITIES:</b>				
Deposits	\$ 2,302,849	\$ -	\$ 2,228,210	\$ -
Short-Term Borrowings	61,058	-	64,947	-
Subordinated Notes Payable	62,887	-	49,230	-
Long-Term Borrowings	28,265	-	30,448	-

All non-financial instruments are excluded from the above table. The disclosures also do not include goodwill. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

**NOTE 8 – OTHER COMPREHENSIVE INCOME**

The amounts allocated to other comprehensive income are presented in the table below. Reclassification adjustments related to securities held for sale are included in net gain/loss on securities transactions in the accompanying consolidated statements of comprehensive income. For the periods presented, reclassifications adjustments related to securities held for sale was not material.

<i>(Dollars in Thousands)</i>	<b>Before Tax Amount</b>	<b>Tax (Expense) Benefit</b>	<b>Net of Tax Amount</b>
<b>Three Months Ended June 30, 2016</b>			
Investment Securities:			
Change in net unrealized gain/loss on securities available for sale	\$ 908	\$ (350)	\$ 558
Amortization of losses on securities transferred from available for sale to held to maturity	20	(8)	12
Total Other Comprehensive Income	\$ 928	\$ (358)	\$ 570
<b>Six Months Ended June 30, 2016</b>			
Investment Securities:			
Change in net unrealized gain/loss on securities available for sale	\$ 2,692	\$ (1,038)	\$ 1,654
Amortization of losses on securities transferred from available for sale to held to maturity	39	(15)	24
Total Other Comprehensive Income	\$ 2,731	\$ (1,053)	\$ 1,678
<i>(Dollars in Thousands)</i>	<b>Before Tax Amount</b>	<b>Tax (Expense) Benefit</b>	<b>Net of Tax Amount</b>
<b>Three Months Ended June 30, 2015</b>			
Investment Securities:			
Change in net unrealized gain/loss on securities available for sale	\$ (117)	\$ 44	\$ (73)
Amortization of losses on securities transferred from available for sale to held to maturity	19	(7)	12
Total Other Comprehensive Loss	\$ (98)	\$ 37	\$ (61)
<b>Six Months Ended June 30, 2015</b>			
Investment Securities:			
Change in net unrealized gain/loss on securities available for sale	\$ 1,029	\$ (397)	\$ 632
Amortization of losses on securities transferred from available for sale to held to maturity	36	(14)	22
Total Other Comprehensive Income	\$ 1,065	\$ (411)	\$ 654

Accumulated other comprehensive loss was comprised of the following components:

<i>(Dollars in Thousands)</i>	<b>Securities Available for Sale</b>	<b>Retirement Plans</b>	<b>Accumulated Other Comprehensive Loss</b>
<b>Balance as of January 1, 2016</b>	\$ (127)	\$ (22,130)	\$ (22,257)
Other comprehensive income during the period	1,678	-	1,678
<b>Balance as of June 30, 2016</b>	\$ 1,551	\$ (22,130)	\$ (20,579)
<b>Balance as of January 1, 2015</b>	\$ 59	\$ (21,568)	\$ (21,509)
Other comprehensive income during the period	654	-	654
<b>Balance as of June 30, 2015</b>	\$ 713	\$ (21,568)	\$ (20,855)

## NOTE 9 – ACCOUNTING STANDARDS UPDATES

*ASU 2016-01, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities."* ASU 2016-1, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. ASU 2016-1 will be effective for the Company on January 1, 2018 and is not expected to have a significant impact on its financial statements.

*ASU 2016-02, "Leases (Topic 842)."* ASU 2016-02 requires the lease rights and obligations arising from lease contracts, including existing and new arrangements, to be recognized as assets and liabilities on the balance sheet. ASU 2016-02 is effective for the Company January 1, 2019. The Company is currently evaluating the effect that this guidance will have on its consolidated financial statements.

*ASU 2016-07, "Investments-Equity Method and Joint Ventures (Topic 323) – Simplifying the Transition to the Equity Method of Accounting."* ASU 2016-07 eliminates the requirement that when an investment qualifies for the use of the equity method as a result in the increase in ownership interest, to retroactively apply the equity method of accounting to all previous periods that the investment was held. The amendments require that the equity method investor add the cost of acquiring the additional interest to the current basis of the investment. ASU 2016-07 will be effective for the Company on January 1, 2017 and is not expected to have a significant impact on its financial statements.

*ASU 2016-09, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting."* Under ASU 2016-09 all excess tax benefits and tax deficiencies related to share-based payment awards should be recognized as income tax expense or benefit in the income statement during the period in which they occur. Previously, such amounts were recorded in the pool of excess tax benefits included in additional paid-in capital, if such pool was available. Because excess tax benefits are no longer recognized in additional paid-in capital, the assumed proceeds from applying the treasury stock method when computing earnings per share should exclude the amount of excess tax benefits that would have previously been recognized in additional paid-in capital. Additionally, excess tax benefits should be classified along with other income tax cash flows as an operating activity rather than a financing activity, as was previously the case. ASU 2016-09 also provides that an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest (current GAAP) or account for forfeitures when they occur. ASU 2016-09 changes the threshold to qualify for equity classification (rather than as a liability) to permit withholding up to the maximum statutory tax rates (rather than the minimum as was previously the case) in the applicable jurisdictions. ASU 2016-09 will be effective for the Company on January 1, 2017 and is not expected to have a significant impact on its financial statements.

ASU 2016-13, “*Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Statements.*” ASU 2016-13 requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization’s portfolio. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 will be effective for the Company on January 1, 2020. The Company is currently evaluating the potential impact of ASU 2016-13 on its financial statements.

#### **NOTE 10 – RELATED PARTY TRANSACTIONS**

On June 15, 2016, the Company entered into a negotiated private transaction to repurchase 426,845 shares of its common stock from the Estate of Robert H. Smith, a 5% beneficial owner of the Company’s common stock. The purchase price per share was \$14.50. The transaction was reviewed, processed and approved in accordance with the Company’s Related Party Transaction Policy.



**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Management's discussion and analysis ("MD&A") provides supplemental information, which sets forth the major factors that have affected our financial condition and results of operations and should be read in conjunction with the Consolidated Financial Statements and related notes. The following information should provide a better understanding of the major factors and trends that affect our earnings performance and financial condition, and how our performance during 2016 compares with prior years. Throughout this section, Capital City Bank Group, Inc., and subsidiaries, collectively, is referred to as "CCBG," "Company," "we," "us," or "our."

**CAUTION CONCERNING FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q, including this MD&A section, contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, among others, statements about our beliefs, plans, objectives, goals, expectations, estimates and intentions that are subject to significant risks and uncertainties and are subject to change based on various factors, many of which are beyond our control. The words "may," "could," "should," "would," "believe," "anticipate," "estimate," "expect," "intend," "plan," "target," "goal," and similar expressions are intended to identify forward-looking statements.

All forward-looking statements, by their nature, are subject to risks and uncertainties. Our actual future results may differ materially from those set forth in our forward-looking statements. Please see the Introductory Note and *Item 1A. Risk Factors* of our 2015 Report on Form 10-K, as updated in our subsequent quarterly reports filed on Form 10-Q, and in our other filings made from time to time with the SEC after the date of this report.

However, other factors besides those listed in our Quarterly Report or in our Annual Report also could adversely affect our results, and you should not consider any such list of factors to be a complete set of all potential risks or uncertainties. Any forward-looking statements made by us or on our behalf speak only as of the date they are made. We do not undertake to update any forward-looking statement, except as required by applicable law.

**BUSINESS OVERVIEW**

We are a financial holding company headquartered in Tallahassee, Florida, and we are the parent of our wholly-owned subsidiary, Capital City Bank (the "Bank" or "CCB"). The Bank offers a broad array of products and services through a total of 61 full-service offices located in Florida, Georgia, and Alabama. The Bank offers commercial and retail banking services, as well as trust and asset management, retail securities brokerage and data processing services.

Our profitability, like most financial institutions, is dependent to a large extent upon net interest income, which is the difference between the interest and fees received on earning assets, such as loans and securities, and the interest paid on interest-bearing liabilities, principally deposits and borrowings. Results of operations are also affected by the provision for loan losses, operating expenses such as salaries and employee benefits, occupancy and other operating expenses including income taxes, and noninterest income such as deposit fees, wealth management fees, mortgage banking fees, bank card fees, and data processing fees.

A detailed discussion regarding the economic conditions in our markets and our long-term strategic objectives is included as part of the MD&A section of our 2015 Form 10-K.

## NON-GAAP FINANCIAL MEASURES

We present a tangible capital ratio that excludes the impact of intangible assets. We believe this measure is useful to investors because, by removing the effect of intangible assets that result from merger and acquisition activity, it allows investors to more easily compare our capital adequacy to other companies in the industry. The GAAP to non-GAAP reconciliation is provided below.

	2016			2015			2014
<i>(Dollars in Thousands)</i>	Second	First	Fourth	Third	Second	First	Fourth
<b>TANGIBLE CAPITAL RATIO</b>							
Shareowners' Equity (GAAP)	\$ 274,824	\$ 276,833	\$ 274,352	\$ 273,659	\$ 272,038	\$ 274,087	\$ 274,087
Less: Goodwill (GAAP)	84,811	84,811	84,811	84,811	84,811	84,811	84,811
Tangible Shareowners' Equity (non-GAAP) A	190,013	192,022	189,541	188,848	187,227	189,276	189,276
Total Assets (GAAP)	2,767,636	2,792,186	2,797,860	2,615,094	2,654,144	2,693,715	2,693,715
Less: Goodwill (GAAP)	84,811	84,811	84,811	84,811	84,811	84,811	84,811
Tangible Assets (non-GAAP) B	\$2,682,825	\$2,707,375	\$2,713,049	\$2,530,283	\$2,569,333	\$2,608,904	\$2,608,904
Tangible Capital Ratio	A/B 7.08%	7.09%	6.99%	7.46%	7.29%	7.26%	7.26%

**SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)**

	2016			2015			
<i>(Dollars in Thousands, Except Per Share Data)</i>	Second	First	Fourth	Third	Second	First	Fourth
<b>Summary of Operations:</b>							
Interest Income	\$ 20,174	\$ 20,044	\$ 20,602	\$ 19,877	\$ 19,833	\$ 19,346	\$ 19,877
Interest Expense	798	834	808	811	849	839	811
Net Interest Income	19,376	19,210	19,794	19,066	18,984	18,507	19,066
Provision for Loan Losses	(97)	452	513	413	375	293	413
Net Interest Income After Provision for Loan Losses	19,473	18,758	19,281	18,653	18,609	18,214	18,653
Noninterest Income <sup>(3)(4)</sup>	15,215	12,677	13,221	13,228	14,794	12,848	13,228
Noninterest Expense	28,702	28,930	28,280	29,164	28,439	29,390	29,164
Income Before Income Taxes	5,986	2,505	4,222	2,717	4,964	1,672	2,717
Income Tax Expense	2,056	858	1,620	1,034	1,119	686	1,034
Net Income	3,930	1,647	2,602	1,683	3,845	986	1,683
Net Interest Income (FTE)	\$ 19,617	\$ 19,421	\$ 20,006	\$ 19,253	\$ 19,119	\$ 18,611	\$ 19,253
<b>Per Common Share:</b>							
Net Income Basic	\$ 0.22	\$ 0.10	\$ 0.16	\$ 0.09	\$ 0.22	\$ 0.06	\$ 0.09
Net Income Diluted	0.22	0.10	0.16	0.09	0.22	0.06	0.09
Cash Dividends Declared	0.04	0.04	0.04	0.03	0.03	0.03	0.03
Diluted Book Value	16.31	16.04	15.93	15.89	15.80	15.59	15.89
Market Price:							
High	15.96	15.88	16.05	15.75	16.32	16.33	15.75
Low	13.16	12.83	13.56	14.39	13.94	13.16	14.39
Close	13.92	14.59	15.35	14.92	15.27	16.25	14.92
<b>Selected Average Balances:</b>							
Loans, Net	\$1,531,777	\$1,507,508	\$1,492,521	\$1,483,657	\$1,473,954	\$1,448,617	\$1,483,657
Earning Assets	2,447,777	2,440,718	2,353,729	2,310,823	2,328,012	2,306,485	2,310,823
Total Assets	2,767,854	2,763,746	2,678,214	2,639,692	2,670,701	2,648,551	2,639,692
Deposits	2,276,553	2,258,600	2,174,718	2,137,433	2,178,399	2,163,376	2,137,433
Shareowners' Equity	279,532	277,464	275,893	274,956	274,421	275,304	274,956
Common Equivalent Average Shares:							
Basic	17,144	17,202	17,145	17,150	17,296	17,508	17,150
Diluted	17,196	17,235	17,214	17,229	17,358	17,555	17,229
<b>Performance Ratios:</b>							
Return on Average Assets	0.57%	0.24%	0.39%	0.25%	0.58%	0.15%	0.39%
Return on Average Equity	5.65	2.39	3.74	2.43	5.62	1.45	3.74
Net Interest Margin (FTE)	3.22	3.20	3.37	3.31	3.29	3.27	3.31
Noninterest Income as % of Operating Revenue	43.99	39.76	40.05	40.96	43.80	40.98	40.96
Efficiency Ratio	82.40	90.13	85.11	89.79	83.85	93.42	89.79

**Asset Quality:**

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Allowance for Loan Losses	\$	13,677	\$	13,613	13,953	\$	14,737	\$	15,236	\$	16,090	\$
Allowance for Loan Losses to Loans		0.89%		0.90%	0.93%		0.99%		1.03%		1.10%	
Nonperforming Assets (“NPAs”)		22,836		26,499	29,595		38,357		45,487		50,625	
NPAs to Total Assets		0.83		0.95	1.06		1.47		1.71		1.88	
NPAs to Loans plus OREO		1.48		1.73	1.94		2.54		3.00		3.38	
Allowance to Non-Performing Loans		166.50		150.44	135.40		112.17		99.46		95.83	
Net Charge-Offs to Average Loans		(0.04)		0.21	0.34		0.24		0.33		0.49	

**Capital Ratios:**

Tier 1 Capital		15.63%		16.39%	16.42%		16.36%		15.83%		16.16%	
Total Capital		16.44		17.20	17.25		17.24		16.72		17.11	
Common Equity Tier 1 <sup>(1)</sup>		12.65		12.82	12.84		12.76		12.34		12.57	
Leverage		9.88		10.34	10.65		10.71		10.53		10.73	
Tangible Capital <sup>(2)</sup>		7.08		7.09	6.99		7.46		7.29		7.26	

<sup>(1)</sup>Not Applicable prior to January 1, 2015.

<sup>(2)</sup>Non-GAAP financial measure. See non-GAAP reconciliation on page 27.

<sup>(3)</sup>Includes \$2.5 million gain on retirement of trust preferred securities in second quarter, 2016.

<sup>(4)</sup>Includes \$1.7 million in bank-owned life insurance proceeds in second quarter, 2015.

## FINANCIAL OVERVIEW

A summary overview of our financial performance is provided below.

### Results of Operations

- Net income of \$3.9 million, or \$0.22 per diluted share, for the second quarter of 2016 compared to net income of \$1.6 million, or \$0.10 per diluted share, for the first quarter of 2016, and net income of \$3.8 million, or \$0.22 per diluted share for the second quarter of 2015. For the first six months of 2016, we realized net income of \$5.6 million, or \$0.32 per diluted share, compared to net income of \$4.8 million, or \$0.28 per diluted share, for the same period of 2015.
- Tax equivalent net interest income for the second quarter of 2016 was \$19.6 million compared to \$19.4 million for the first quarter of 2016 and \$19.1 million for the second quarter of 2015. For the first six months of 2016, tax equivalent net interest income totaled \$39.0 million compared to \$37.7 million in 2015. The increase over the first quarter of 2016 primarily reflects a positive shift in earning asset mix due to growth in the loan and investment portfolios. Compared to second quarter of 2015, the increase primarily reflects growth in the investment portfolio and a higher rate paid on overnight funds. The year-over-year increase was driven by one additional calendar day, and growth in the loan and investment portfolios.
- Total credit costs (loan loss provision plus other real estate owned (“OREO”) expenses) were \$1.0 million, \$1.9 million, and \$1.3 million for the quarters ended June 30, 2016, March 31, 2016, and June 30, 2015, respectively. Strong loan recoveries and lower property valuation adjustments favorably impacted the loan loss provision and OREO expense, respectively, for the second quarter of 2016. Total credit costs for the six month period of 2016 were \$2.8 million compared to \$3.1 million for the same period of 2015.
- Noninterest income for the second quarter of 2016 totaled \$15.2 million, an increase of \$2.5 million, or 20.0%, over the first quarter of 2016 and \$0.4 million, or 2.8%, over the second quarter of 2015. For the first six months of 2016, noninterest income totaled \$27.9 million, a \$0.2 million, or 0.9% increase over the same period of 2015. The increase over the first quarter of 2016 was primarily due to a \$2.5 million gain from the retirement of \$10 million of our trust preferred securities (“TRUPs”). The increase over the second quarter of 2015 primarily reflects the \$2.5 million TRUPs gain partially offset by lower bank owned life insurance (“BOLI”) income of \$1.7 million and lower deposit fees of \$0.4 million. The increase for the six month period was primarily due to the \$2.5 million TRUPs gain that was partially offset by lower BOLI income of \$1.7 million, lower deposit fees of \$0.5 million, and wealth management fees of \$0.3 million.

- Noninterest expense (excluding OREO expense) for the second quarter of 2016 totaled \$27.6 million, an increase of \$0.1 million, or 0.5%, over both the first quarter of 2016 and the second quarter of 2015. The increase over the first quarter of 2016 and second quarter of 2015 was primarily attributable to higher occupancy and other expense (advertising), partially offset by lower compensation. For the first six months of 2016, noninterest expense totaled \$55.1 million, a decrease of \$0.3 million, or 0.5%, from the same period of 2015 primarily due to lower compensation expense.

## Financial Condition

- Average earning assets totaled \$2.448 billion for the second quarter of 2016, an increase of \$7.1 million, or 0.3%, over the first quarter of 2016, and \$94.0 million, or 4.0%, over the fourth quarter of 2015. The increase in earning assets over the first quarter of 2016 reflects growth in both the loan and investment portfolios, which was funded by a reduction in our funds sold position and growth in non-maturity deposits, primarily noninterest bearing. The increase compared to the fourth quarter of 2015 reflects growth in the loan and investment portfolios, funded primarily by increases in noninterest bearing, NOW, and savings accounts.
- Average loans increased by \$24.3 million, or 1.6%, over the first quarter of 2016 and \$39.3 million, or 2.6%, over the fourth quarter of 2015. The increase compared to the first quarter of 2016 reflects growth primarily in institutional, commercial, and consumer loans. Growth over the fourth quarter of 2015 was experienced in all loan products, with the exception of commercial mortgages.
- Nonperforming assets totaled \$22.8 million at the end of the second quarter of 2016, a decrease of \$3.7 million from the first quarter of 2016 and \$6.8 million from the fourth quarter of 2015. Nonperforming assets represented 0.83% of total assets at June 30, 2016 compared to 0.95% at March 31, 2016 and 1.06% at December 31, 2015.
- As of June 30, 2016, we were well-capitalized with a risk based capital ratio of 16.44% and a tangible common equity ratio of 7.08% compared to 17.20% and 7.09%, respectively, at March 31, 2016, and 17.25% and 6.99%, respectively, at December 31, 2015. The lower risk based capital ratio compared to prior quarters reflects the retirement of \$10 million of our TRUPS and the repurchase of 432,000 shares of CCBG common stock. All of our regulatory capital ratios significantly exceed the threshold to be well-capitalized under the Basel III capital standards.

**RESULTS OF OPERATIONS****Net Income**

For the second quarter of 2016, we realized net income of \$3.9 million, or \$0.22 per diluted share, compared to net income of \$1.6 million, or \$0.10 per diluted share for the first quarter of 2016, and net income of \$3.8 million, or \$0.22 per diluted share, for the second quarter of 2015. For the first six months of 2016, we realized net income of \$5.6 million, or \$0.32 per diluted share, compared to net income of \$4.8 million, or \$0.28 per diluted share for the same period of 2015.

Compared to the first quarter of 2016, performance reflects higher net interest income of \$0.2 million, a \$2.5 million increase in noninterest income, lower noninterest expense of \$0.2 million, and a \$0.6 million reduction in the loan loss provision, partially offset by a \$1.2 million increase in income taxes.

Compared to the second quarter of 2015, the increase in earnings reflects higher net interest income of \$0.4 million, a \$0.4 million increase in noninterest income, and a \$0.5 million reduction in the loan loss provision, partially offset by a \$0.3 million increase in noninterest expense and \$0.9 million increase in income taxes.

The increase in earnings for the first six months of 2016 versus the comparable period of 2015 was attributable to higher net interest income of \$1.1 million, a \$0.3 million increase in noninterest income, lower noninterest expense of \$0.2 million, and a \$0.3 million reduction in the loan loss provision, partially offset by higher income taxes of \$1.1 million.

A condensed earnings summary of each major component of our financial performance is provided below:

	<b>Three Months Ended</b>			<b>Six Months Ended</b>	
	<b>June 30, 2016</b>	<b>March 31, 2016</b>	<b>June 30, 2015</b>	<b>June 30, 2016</b>	<b>June 30, 2015</b>
<i>(Dollars in Thousands, except per share data)</i>					
Interest Income	\$ 20,174	\$ 20,044	\$ 19,833	\$ 40,218	\$ 39,179
Taxable Equivalent Adjustments	241	211	135	452	239
Total Interest Income (FTE)	20,415	20,255	19,968	40,670	39,418
Interest Expense	798	834	849	1,632	1,688
Net Interest Income (FTE)	19,617	19,421	19,119	39,038	37,730
Provision for Loan Losses	(97)	452	375	355	668
Taxable Equivalent Adjustments	241	211	135	452	239

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Net Interest Income After provision for Loan Losses	19,473	18,758	18,609	38,231	36,823
Noninterest Income	15,215	12,677	14,794	27,892	27,642
Noninterest Expense	28,702	28,930	28,439	57,632	57,829
Income Before Income Taxes	5,986	2,505	4,964	8,491	6,636
Income Tax Expense	2,056	858	1,119	2,914	1,805
Net Income	\$ 3,930	\$ 1,647	\$ 3,845	\$ 5,577	\$ 4,831
Basic Net Income Per Share	\$ 0.22	\$ 0.10	\$ 0.22	\$ 0.32	\$ 0.28
Diluted Net Income Per Share	\$ 0.22	\$ 0.10	\$ 0.22	\$ 0.32	\$ 0.28

**Net Interest Income**

Net interest income represents our single largest source of earnings and is equal to interest income and fees generated by earning assets less interest expense paid on interest bearing liabilities. This information is provided on a "taxable equivalent" basis to reflect the tax-exempt status of income earned on certain loans and investments, the majority of which are state and local government debt obligations. We provide an analysis of our net interest income including average yields and rates in Table I on page 42.

Tax equivalent net interest income for the second quarter of 2016 was \$19.6 million compared to \$19.4 million for the first quarter of 2016 and \$19.1 million for the second quarter of 2015. For the first six months of 2016, tax equivalent net interest income totaled \$39.0 million compared to \$37.7 million for the same period of 2015. The increase in tax equivalent net interest income compared to the first quarter of 2016 reflects a positive shift in earning asset mix due to growth in the loan and investment portfolios, partially offset by a decline in overnight funds. The increase in tax equivalent net interest income compared to the second quarter of 2015 reflects growth in the investment portfolio and a higher rate paid on overnight funds, partially offset by a decline in loan fees. The year-over-year increase was driven by one additional calendar day, and growth in the loan and investment portfolios.



Although the low interest rate environment continues to put downward pressure on our net interest income, we have been successful in increasing our net interest income quarter over quarter. Additionally, aggressive lending competition in all markets has impacted the pricing for loans. Low rates and competition, collectively, continue to adversely impact our loan yields. Various loan strategies, which align with our overall risk appetite, continue to be reviewed and implemented to enhance our performance.

Our net interest margin for the second quarter of 2016 was 3.22%, an increase of two basis points over the first quarter of 2016 and a decrease of seven basis points from the second quarter of 2015. The increase in the margin compared to the first quarter of 2016 was primarily attributable to growth in our loan and investment portfolios. The decrease in the margin compared to the second quarter of 2015 was primarily attributable to lower loan yields. For the first six months of 2016, the net interest margin declined by seven basis points to 3.21% compared to the same period of 2015 for reasons mentioned above.

We continue to maintain short duration portfolios on both sides of the balance sheet and believe we are well positioned to respond to changing market conditions. Over time, this strategy has historically produced fairly consistent outcomes and a net interest margin that is significantly above peer comparisons.

### **Provision for Loan Losses**

The provision for loan losses for the second quarter of 2016 was negative \$0.1 million reflecting a higher level of loan recoveries as well as continued improvement in credit quality. This compares to a \$0.5 million provision expense for the first quarter of 2016 and a \$0.4 million provision expense for the second quarter of 2015. For the first six months of 2016, the loan loss provision totaled \$0.4 million compared to \$0.7 million for the same period of 2015. The decrease in the year-to-date provision reflects a high level of recoveries, continued favorable problem loan migration and improvement in key credit metrics, partially offset by growth in the loan portfolio. We realized net loan recoveries of \$0.2 million (consisting of recoveries of \$1.3 million less charge-offs of \$1.1 million) for the second quarter of 2016. This compares to net charge-offs of \$0.8 million, or 0.21% (annualized) of average loans for the first quarter of 2016 and \$1.2 million, or 0.33% (annualized), for the second quarter of 2015. For the first six months of 2016, net charge-offs totaled \$0.6 million, or 0.08% (annualized) of average loans compared to \$3.0 million, or 0.41% (annualized), for the same period of 2015. At quarter-end, the allowance for loan losses of \$13.7 million was 0.89% of outstanding loans (net of overdrafts) and provided coverage of 167% of nonperforming loans compared to 0.90% and 150%, respectively, at March 31, 2016 and 0.93% and 135%, respectively, at December 31, 2015.

Charge-off activity for the respective periods is set forth below:

<i>(Dollars in Thousands, except per share data)</i>	Three Months Ended			Six Months Ended	
	June 30, 2016	March 31, 2016	June 30, 2015	June 30, 2016	June 30, 2015
<b>CHARGE-OFFS</b>					
Commercial, Financial and Agricultural	\$ 304	\$ 37	\$ 239	\$ 341	\$ 529
Real Estate - Construction	-	-	-	-	-
Real Estate - Commercial Mortgage	-	274	285	274	1,189
Real Estate - Residential	205	478	484	683	789
Real Estate - Home Equity	146	215	454	361	636
Consumer	438	439	351	877	927
Total Charge-offs	\$ 1,093	\$ 1,443	\$ 1,813	\$ 2,536	\$ 4,070
<b>RECOVERIES</b>					
Commercial, Financial and Agricultural	\$ 49	\$ 39	\$ 82	\$ 88	\$ 137
Real Estate - Construction	-	-	-	-	-
Real Estate - Commercial Mortgage	237	81	54	318	84
Real Estate - Residential	579	236	200	815	248
Real Estate - Home Equity	81	59	33	140	57
Consumer	308	236	215	544	573
Total Recoveries	\$ 1,254	\$ 651	\$ 584	\$ 1,905	\$ 1,099
Net (Recoveries) Charge-offs	\$ (161)	\$ 792	\$ 1,229	\$ 631	\$ 2,971
Net (Recoveries) Charge-offs (Annualized) as a percent of Average Loans Outstanding, Net of Unearned Income	(0.04)%	0.21%	0.33%	0.08%	0.41%

### Noninterest Income

Noninterest income for the second quarter of 2016 totaled \$15.2 million, an increase of \$2.5 million, or 20.0%, over the first quarter of 2016 and \$0.4 million, or 2.8%, over the second quarter of 2015. The increase over the first quarter of 2016 was primarily attributable to higher other income of \$2.5 million reflecting a \$2.5 million gain from the retirement of our TRUPs (this transaction is further detailed in the Borrowings section). Compared to the second quarter of 2015, the increase was attributable to higher other income of \$0.8 million reflecting the \$2.5 million TRUPs gain, partially offset by lower bank owned life insurance ("BOLI") income of \$1.7 million and lower deposit fees of \$0.4 million. For the first six months of 2016, noninterest income totaled \$27.9 million, a \$0.2 million increase over the same period of 2015, primarily attributable to higher other income of \$0.9 million (\$2.5 million TRUPs gain partially offset by lower BOLI income of \$1.7 million) that was further offset by lower deposit fees of \$0.5 million and wealth management fees of \$0.3 million.

Noninterest income represented 44.0% of operating revenues (net interest income plus noninterest income) in the second quarter of 2016 compared to 39.8% in the first quarter of 2016 and 43.8% in the second quarter of 2015. For the first six months of 2016, noninterest income represented 42.0% of operating revenues compared to 42.4% for the same period of 2015.

The table below reflects the major components of noninterest income.

<i>(Dollars in Thousands)</i>	Three Months Ended			Six Months Ended	
	June 30, 2016	March 31, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Deposit Fees	\$ 5,321	\$ 5,400	\$ 5,682	\$ 10,721	\$ 11,223
Bank Card Fees	2,855	2,853	2,844	5,708	5,586
Wealth Management Fees	1,690	1,792	1,776	3,482	3,822
Mortgage Banking Fees	1,267	1,030	1,203	2,297	2,190
Data Processing Fees	335	347	364	682	737
Other	3,747	1,255	2,925	5,002	4,084
<b>Total Noninterest Income</b>	<b>\$ 15,215</b>	<b>\$ 12,677</b>	<b>\$ 14,794</b>	<b>\$ 27,892</b>	<b>\$ 27,642</b>

Significant components of noninterest income are discussed in more detail below.

*Deposit Fees.* Deposit fees for the second quarter of 2016 totaled \$5.3 million, a decrease of \$0.1 million, or 1.5%, over the first quarter of 2016 and a decrease of \$0.4 million, or 6.4%, from the second quarter of 2015. For the first six months of 2016, deposit fees totaled \$10.7 million, a decrease of \$0.5 million, or 4.5%, from the comparable period of 2015. The decrease from all prior periods reflects lower overdraft service fees attributable to a reduction in accounts using this service as well as lower utilization by existing users.

*Wealth Management Fees.* Wealth management fees, which include both trust fees (i.e., managed accounts, trusts/estates, and retirement plans) and retail brokerage fees (i.e., investment and insurance products) totaled \$1.7 million for the second quarter of 2016, a decrease of \$0.1 million, or 5.7%, from the first quarter of 2016 and \$0.1 million, or 4.8%, from the second quarter of 2015. For the first six months of 2016, wealth management fees totaled \$3.5 million, a decrease of \$0.3 million, or 8.9%, from the same period of 2015. The decrease from all prior periods was primarily due to lower retail brokerage fees reflecting lower trading volume by our clients. At June 30, 2016, total assets under management were approximately \$1.178 billion compared to \$1.139 billion at December 31, 2015 and \$1.141 billion at June 30, 2015.

*Mortgage Banking Fees.* Mortgage banking fees totaled \$1.3 million for the second quarter of 2016, an increase of \$0.2 million, or 23.0%, over the first quarter of 2016 and an increase of \$0.1 million, or 5.3%, over the second quarter of 2015. For the first six months of 2016, fees totaled \$2.3 million, an increase of \$0.1 million, or 4.9%, over the same period of 2015. We continue to realize strong residential home sales activity in our markets which drove the increase for all periods.

*Other.* Other income totaled \$3.7 million for the second quarter of 2016, an increase of \$2.5 million, or 198.6%, over the first quarter of 2016 and an increase of \$0.8 million, or 28.1%, over the second quarter of 2015. For the first six months of 2016, other income increased \$0.9 million, or 22.5%, compared to the same period of 2015. The increase over the first quarter of 2016 was attributable to a \$2.5 million gain from the retirement of our TRUPs. The variance compared to both prior year periods primarily reflects the \$2.5 million TRUPs gain that was partially offset by lower BOLI income of \$1.7 million.

### **Noninterest Expense**

Noninterest expense for the second quarter of 2016 totaled \$28.7 million, a decrease of \$0.2 million, or 2.0%, from the first quarter of 2016 primarily attributable to lower OREO expense of \$0.4 million reflective of lower property valuation adjustments and carrying costs. Compared to the second quarter of 2015, noninterest expense increased by \$0.3 million, or 0.9%, attributable to higher occupancy expense, primarily higher maintenance costs for building and furniture/equipment. For the first six months of 2016, noninterest expense totaled \$57.6 million, a decrease of \$0.2 million, or 0.3%, from the same period of 2015 attributable to lower compensation expense of \$0.6 million that was partially offset by higher occupancy expense of \$0.4 million. A higher level of deferred loan cost (which reduces salary expense), partially offset by pension plan expense drove the reduction in compensation. The variance in occupancy expense was attributable to the same factors noted above for the second quarter. Expense management is an important part of our culture and strategic focus and we continue to review and evaluate opportunities to optimize our operations, reduce operating costs and manage our discretionary expenses.

The table below reflects the major components of noninterest expense.

<i>(Dollars in Thousands)</i>	Three Months Ended			Six Months Ended	
	June 30, 2016	March 31, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Salaries	\$ 11,832	\$ 11,934	\$ 12,435	\$ 23,766	\$ 24,950
Associate Benefits	4,219	4,307	3,969	8,526	7,978
Total Compensation	16,051	16,241	16,404	32,292	32,928
Premises	2,276	2,307	2,181	4,583	4,457
Equipment	2,308	2,152	2,077	4,460	4,197
Total Occupancy	4,584	4,459	4,258	9,043	8,654
Legal Fees	638	699	691	1,337	1,396
Professional Fees	891	862	1,022	1,753	2,067
Processing Services	1,648	1,702	1,642	3,350	3,420
Advertising	529	340	305	869	645
Travel and Entertainment	226	196	227	423	438
Printing and Supplies	191	203	184	394	388
Telephone	469	470	479	938	1,014
Postage	223	261	235	484	516
Insurance - Other	633	628	702	1,261	1,407
Other Real Estate Owned, net	1,060	1,425	931	2,485	2,428
Miscellaneous	1,559	1,444	1,359	3,003	2,528
Total Other	8,067	8,230	7,777	16,297	16,247
<b>Total Noninterest Expense</b>	<b>\$ 28,702</b>	<b>\$ 28,930</b>	<b>\$ 28,439</b>	<b>\$ 57,632</b>	<b>\$ 57,829</b>

Significant components of noninterest expense are discussed in more detail below.

*Compensation.* Compensation expense totaled \$16.1 million for the second quarter of 2016, a decrease of \$0.2 million, or 1.2%, from the first quarter of 2016 due to a \$0.1 million decrease in salary expense and \$0.1 million reduction in associate benefit expense. Lower payroll and unemployment taxes drove the decrease in salary expense and the decrease in associate benefit expense reflects lower employee insurance expense. Compared to the second quarter of 2016, total compensation expense decreased \$0.4 million, or 2.2% attributable to lower salary expense of \$0.6 million that was partially offset by higher associate benefit expense of \$0.2 million. The decrease in salary expense was primarily attributable to higher deferred loan costs (which reduces salary expense). The increase in associate benefit expense was attributable to higher pension plan expense. For the first six months of 2016, compensation expense totaled \$32.3 million, a decrease of \$0.6 million, or 1.9%, over the same period of 2015 due to lower salary expense of \$1.2 million that was partially offset by higher associate benefit expense of \$0.6 million. Both variances were attributable to the same factors noted above for the second quarter.

*Occupancy.* Occupancy expense (including premises and equipment) totaled \$4.6 million for the second quarter of 2016, an increase of \$0.1 million, or 2.8%, over the first quarter of 2016 reflective of higher maintenance costs for

furniture/equipment. Compared to the second quarter of 2015, occupancy expense increased \$0.3 million, or 7.7%, primarily attributable to higher maintenance costs for building and furniture/equipment and to a lesser extent higher depreciation expense from technology investments in our banking offices. For the first six months of 2016, occupancy expense increased \$0.4 million, or 4.5%, over the same period of 2015 attributable to the same factors noted above for the second quarter.

*Other.* Other noninterest expense decreased \$0.2 million, or 0.8%, from the first quarter of 2016, and increased \$0.3 million, or 0.9%, from the second quarter of 2015. Compared to the first quarter of 2016, the decrease was primarily attributable to lower OREO expense of \$0.4 million partially offset by higher advertising costs of \$0.2 million. The decrease in OREO expense reflects lower property valuation adjustments and carrying costs. Advertising expense increased due to various advertising campaigns related to the promotion of a new checking account line-up and working capital financing product. Compared to the second quarter of 2015, the increase was primarily due to higher advertising expense of \$0.2 million and miscellaneous expense of \$0.2 million partially offset by lower professional fees of \$0.1 million. Advertising expense increased due to the same factors noted above for the first quarter. Miscellaneous expense increased due to losses on the disposal of our fixed assets and a higher level of debit card losses. Higher consulting expenses in the second quarter of 2015 drove the reduction in professional fees. For the first six months of 2016, other expense increased \$0.1 million, or 0.3%, from the same period of 2015, primarily attributable to higher miscellaneous expense of \$0.5 million and advertising expenses of \$0.2 million, partially offset by a reduction in professional fees of \$0.3 million and other insurance of \$0.2 million. The increase in advertising expense, professional fees and miscellaneous expense were attributable to the same factors noted above for the second quarter. The decrease in other insurance was attributable to a lower premium rate for our FDIC insurance reflective of improving asset quality.

Our operating efficiency ratio (expressed as noninterest expense as a percent of the sum of taxable-equivalent net interest income plus noninterest income) was 82.40% for the second quarter of 2016 compared to 90.13% for the first quarter of 2016 and 83.85% for the second quarter of 2015. For the first six months of 2016, this ratio was 86.11% compared to 88.46% for the comparable period of 2015. The \$2.5 million gain from the retirement of our TRUPs was the primary reason for the change in this metric compared to the first quarter of 2016.

## **Income Taxes**

We realized income tax expense of \$2.1 million (34% effective rate) for the second quarter of 2016 compared to \$0.9 million (34% effective rate) for the first quarter of 2016 and \$1.2 million (23% effective rate) for the second quarter of 2015. For the first six months of 2016, income tax expense totaled \$2.9 million (34% effective rate) compared to \$1.8 million (27% effective rate) for the same period of 2015. The receipt of \$1.7 million in BOLI proceeds in the second quarter of 2015 was tax-free, therefore income tax expense for the three and six month periods of 2015 was favorably impacted.

## **FINANCIAL CONDITION**

Average assets totaled approximately \$2.768 billion for the second quarter of 2016, an increase of \$4.1 million, or 0.2%, over the first quarter of 2016, and an increase of \$89.6 million, or 3.4%, over the fourth quarter of 2015. Average earning assets were \$2.448 billion for the second quarter of 2016, an increase of \$7.1 million, or 0.3%, over the first quarter of 2016, and an increase of \$94.0 million, or 4.0%, over the fourth quarter of 2015. The change in earning assets over the first quarter of 2016 reflects growth in both the loan and investment portfolios, which was



funded by a reduction in our funds sold position and growth in nonmaturity deposits, primarily noninterest bearing. The increase compared to the fourth quarter of 2015 reflects growth in the loan and investment portfolios, funded primarily by increases in noninterest bearing, NOW, and savings accounts.

### **Investment Securities**

In the second quarter of 2016, our average investment portfolio increased \$14.3 million, or 2.2%, over the first quarter of 2016 and increased \$23.0 million, or 3.6%, over the fourth quarter of 2015. As a percentage of average earning assets, the investment portfolio represented 27.0% in the second quarter of 2016, compared to 26.5% in the first quarter of 2016, and 27.1% in the fourth quarter of 2015. The increase in the average balance of the investment portfolio compared to the first quarter of 2016 was primarily attributable to increases in U.S. Treasury purchases and Ginnie Mae mortgage-backed securities. The increase compared to the fourth quarter of 2015 was primarily attributable to an increase in U.S. Treasury purchases. For the remainder of 2016, it is anticipated that cash flow from the investment portfolio will be reinvested into securities. We will continue to closely monitor liquidity levels, as well as look for new investment products that are prudent relative to our risk profile and overall investment strategy.

The investment portfolio is a significant component of our operations and, as such, it functions as a key element of liquidity and asset/liability management. Two types of classifications are approved for investment securities which are Available-for-Sale ("AFS") and Held-to-Maturity ("HTM"). During the second quarter of 2016, securities were purchased under both the AFS and HTM designations. As of June 30, 2016, \$476.8 million, or 69.9% of the investment portfolio was classified as AFS, with the remaining \$205.6 million, or 30.1%, classified as HTM.

At acquisition, the classification of the security will be determined based on how the purchase will affect our asset/liability strategy and future business plans and opportunities. Such decisions will be weighed against multiple factors, including regulatory capital requirements, volatility in earnings or other comprehensive income, and liquidity needs. Securities in the AFS portfolio are recorded at fair value with unrealized gains and losses associated with these securities recorded net of tax, in the accumulated other comprehensive income component of shareowners' equity. Securities that are HTM will be acquired or owned with the intent of holding them to maturity (final payment date). HTM investments are measured at amortized cost. It is neither management's current intent nor practice to participate in the trading of investment securities for the purpose of recognizing gains and therefore we do not maintain a trading portfolio.

At June 30, 2016, the investment portfolio had a net pre-tax unrealized gain in the AFS portfolio of \$2.8 million compared to an unrealized gain of \$1.9 million and \$1.6 million at March 31, 2016 and December 31, 2015, respectively. At June 30, 2016, there were 79 positions (combined AFS and HTM) with unrealized losses totaling \$0.2 million. Of the 79 positions, 66 were Ginnie Mae mortgage-backed securities (GNMA), U.S. Treasuries, or SBA securities, all of which carry the full faith and credit guarantee of the U.S. Government. SBA securities float monthly or quarterly to the prime rate and are uncapped. Of these 66 positions, there were 21 GNMA positions and 26 SBA positions in an unrealized loss position for longer than 12 months, and have unrealized losses of \$93,000 and \$34,000, respectively. There were 13 municipal bonds in an unrealized loss position that were pre-refunded, or rated "AA-" or better. None of the positions with unrealized losses are considered impaired, and all are expected to mature at par.

The average maturity of the total portfolio at June 30, 2016 was 1.81 years compared to 1.79 years and 1.83 years at March 31, 2016 and December 31, 2015, respectively. The average life of the total portfolio at June 30, 2016 was slightly longer compared to the prior quarter due primarily to purchases of GNMA securities, and slightly shorter than the year-end attributable to the natural aging of the existing portfolio.

## **Loans**

Average loans increased \$24.3 million, or 1.6% when compared to the first quarter of 2016, and have grown \$39.3 million, or 2.6% when compared to the fourth quarter of 2015. The increase compared to the first quarter of 2016 reflects growth primarily in institutional, commercial, and consumer loans. Growth over the fourth quarter of 2015 was experienced in all loan products, with the exception of commercial mortgages.

The resolution of problem loans totaled \$2.3 million for the second quarter of 2016 (\$1.1 million in net charge offs and \$1.2 million transferred to ORE), compared to \$2.6 million from the first quarter of 2016 (\$1.4 million in net charge offs and \$1.2 million transferred to ORE), and \$3.5 million from the fourth quarter 2015 (\$1.9 million in net charge offs and \$1.6 million transferred to ORE). The problem loan resolutions are based on "as of" balances, not averages.

Without compromising our credit standards or taking on inordinate interest rate risk, we continue to make minor modifications on some of our lending programs to try to mitigate the impact that consumer and business deleveraging is having on our portfolio. These programs, coupled with economic improvements in our anchor markets, have helped to increase overall production.

### **Nonperforming Assets**

Nonperforming assets (nonaccrual loans and other real estate owned "OREO") totaled \$22.8 million at the end of the second quarter of 2016, a decrease of \$3.7 million, or 14%, from the first quarter of 2016 and \$6.8 million, or 23%, from the fourth quarter of 2015. Nonaccrual loans totaled \$8.2 million at the end of the second quarter of 2016, a decrease of \$0.9 million from the first quarter of 2016 and \$2.1 million from the fourth quarter of 2015. Nonaccrual loan additions totaled \$2.5 million in the second quarter of 2016 and \$6.3 million for the first six months of 2016, which compares to \$10.3 million for the same period of 2015. The balance of OREO totaled \$14.6 million at the end of the second quarter of 2016, a decrease of \$2.8 million and \$4.7 million, respectively, from the first quarter of 2016 and fourth quarter of 2015. For the second quarter of 2016, we added properties totaling \$1.2 million, sold properties totaling \$3.3 million, and recorded valuation adjustments totaling \$0.7 million. For the first six months of 2016, we added properties totaling \$2.4 million, sold properties totaling \$5.6 million and recorded valuation adjustments totaling \$1.5 million. Nonperforming assets represented 0.83% of total assets at June 30, 2016 compared to 0.95% at March 31, 2016 and 1.06% at December 31, 2015.

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<i>(Dollars in Thousands)</i>	<b>June 30, 2016</b>	<b>March 31, 2016</b>	<b>December 31, 2015</b>
<b>Nonaccruing Loans:</b>			
Commercial, Financial and Agricultural	\$ 163	\$ 83	\$ 96
Real Estate - Construction	123	-	97
Real Estate - Commercial Mortgage	4,308	3,942	4,191
Real Estate - Residential	2,701	3,490	4,739
Real Estate - Home Equity	864	1,323	1,017
Consumer	55	211	165
<b>Total Nonperforming Loans (“NPLs”<sup>(1)</sup>)</b>	<b>\$ 8,214</b>	<b>\$ 9,049</b>	<b>\$ 10,305</b>
<b>Other Real Estate Owned</b>	<b>14,622</b>	<b>17,450</b>	<b>19,290</b>
<b>Total Nonperforming Assets (“NPAs”)</b>	<b>\$ 22,836</b>	<b>\$ 26,499</b>	<b>\$ 29,595</b>
Past Due Loans 30 – 89 Days	\$ 3,872	\$ 3,599	\$ 5,775
Past Due Loans 90 Days or More (accruing)	-	-	-
Performing Troubled Debt Restructurings	\$ 35,526	\$ 36,700	\$ 35,634
Nonperforming Loans/Loans	0.54%	0.60%	0.69%
Nonperforming Assets/Total Assets	0.83	0.95	1.06
Nonperforming Assets/Loans Plus OREO	1.48	1.73	1.94
Allowance/Nonperforming Loans	166.50%	150.44%	135.40%

(1) Nonperforming TDRs are included in the Nonaccrual/NPL totals

Activity within our nonperforming asset portfolio is provided in the table below.

<i>(Dollars in Thousands)</i>	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
<b>NPA Beginning Balance:</b>	\$ 26,499	\$ 50,625	\$ 29,595	\$ 52,449
<b>Change in Nonaccrual Loans:</b>				
Beginning Balance	9,049	16,790	10,305	16,769
Additions	2,480	4,497	6,276	10,264
Charge-Offs	(708)	(1,333)	(1,639)	(2,953)
Transferred to OREO	(978)	(1,088)	(2,179)	(1,705)
Paid Off/Payments	(430)	(2,669)	(1,363)	(3,613)
Restored to Accrual	(1,199)	(877)	(3,186)	(3,442)
<b>Ending Balance</b>	<b>8,214</b>	<b>15,320</b>	<b>8,214</b>	<b>15,320</b>
<b>Change in OREO:</b>				
Beginning Balance	17,450	33,835	19,290	35,680
Additions	1,218	1,088	2,419	2,830
Valuation Write-downs	(678)	(505)	(1,513)	(1,306)
Sales	(3,368)	(4,026)	(5,574)	(6,763)
Other	-	(225)	-	(274)
<b>Ending Balance</b>	<b>14,622</b>	<b>30,167</b>	<b>14,622</b>	<b>30,167</b>
<b>NPA Net Change</b>	<b>(3,663)</b>	<b>(5,138)</b>	<b>(6,759)</b>	<b>(6,962)</b>
<b>NPA Ending Balance</b>	<b>\$ 22,836</b>	<b>\$ 45,487</b>	<b>\$ 22,836</b>	<b>\$ 45,487</b>



Activity within our TDR portfolio is provided in the table below.

<i>(Dollars in Thousands)</i>	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
<b>TDR Beginning Balance:</b>	\$ 38,713	\$ 47,158	\$ 38,321	\$ 49,154
Additions	90	262	1,111	1,156
Charge-Offs	-	(399)	-	(1,283)
Paid Off/Payments	(1,037)	(1,710)	(1,482)	(2,321)
Removal Due to Change in TDR Status	-	-	-	(202)
Transferred to OREO	(227)	(322)	(411)	(1,515)
<b>TDR Ending Balance</b>	<b>\$ 37,539</b>	<b>\$ 44,989</b>	<b>\$ 37,539</b>	<b>\$ 44,989</b>

### **Allowance for Loan Losses**

We maintain an allowance for loan losses at a level that management believes to be sufficient to provide for probable losses inherent in the loan portfolio as of the balance sheet date. Credit losses arise from borrowers' inability or unwillingness to repay, and from other risks inherent in the lending process, including collateral risk, operations risk, concentration risk and economic risk. All related risks of lending are considered when assessing the adequacy of the loan loss reserve. The allowance for loan losses is established through a provision charged to expense. Loans are charged against the allowance when management believes collection of the principal is unlikely. The allowance for loan losses is based on management's judgment of overall loan quality. This is a significant estimate based on a detailed analysis of the loan portfolio. The balance can and will change based on changes in the assessment of the loan portfolio's overall credit quality. We evaluate the adequacy of the allowance for loan losses on a quarterly basis.

The allowance for loan losses was \$13.7 million at June 30, 2016 compared to \$13.6 million at March 31, 2016 and \$14.0 million at December 31, 2015. The allowance for loan losses was 0.89% of outstanding loans and provided coverage of 167% of nonperforming loans at June 30, 2016 compared to 0.90% and 150%, respectively, at March 31, 2016 and 0.93% and 135%, respectively, at December 31, 2015. The increase in the allowance over March 31, 2016 primarily reflects a significant increase in the level of loan recoveries and to a lesser extent lower loan charge-offs. The decrease in the allowance from December 31, 2015 was attributable to a lower level of both general reserves and impaired reserves. The decrease in general reserves reflects stable problem loan migration, lower loss experience, and continued improvement in credit quality metrics, partially offset by reserves for growth in the loan portfolio. The decrease in impaired reserves was driven by a lower level of impaired loans reflecting reduced inflow and successful resolutions as well as lower loss content. It is management's opinion that the allowance at June 30, 2016 is adequate to absorb losses inherent in the loan portfolio at quarter-end.

### **Deposits**

Average total deposits were \$2.277 billion for the second quarter of 2016, an increase of \$18.0 million, or 0.8%, over the first quarter of 2016, and an increase of \$101.8 million, or 4.7% over the fourth quarter of 2015. The increase in

deposits when compared to the first quarter of 2016 reflects growth in all deposit products except public NOW deposits and certificates of deposit. Compared to the fourth quarter of 2015, growth was experienced in all product types other than money market accounts and certificates of deposit. The seasonal inflows of public funds most likely peaked in the first quarter of 2016, and are expected to decline into the fourth quarter of 2016.

Deposit levels remain strong, as the seasonal decline in public NOW accounts was more than offset by increases in all other non-maturity deposits during the quarter. Average core deposits continue to experience growth in this low rate environment. Competitive rates continue to be monitored, as a prudent pricing discipline remains the key to managing our mix of deposits.

## **MARKET RISK AND INTEREST RATE SENSITIVITY**

### **Market Risk and Interest Rate Sensitivity**

*Overview.* Market risk management arises from changes in interest rates, exchange rates, commodity prices, and equity prices. We have risk management policies to monitor and limit exposure to market risk and do not participate in activities that give rise to significant market risk involving exchange rates, commodity prices, or equity prices. In asset and liability management activities, our policies are designed to minimize structural interest rate risk.

*Interest Rate Risk Management.* Our net income is largely dependent on net interest income. Net interest income is susceptible to interest rate risk to the degree that interest-bearing liabilities mature or re-price on a different basis than interest-earning assets. When interest-bearing liabilities mature or re-price more quickly than interest-earning assets in a given period, a significant increase in market rates of interest could adversely affect net interest income. Similarly, when interest-earning assets mature or re-price more quickly than interest-bearing liabilities, falling interest rates could result in a decrease in net interest income. Net interest income is also affected by changes in the portion of interest-earning assets that are funded by interest-bearing liabilities rather than by other sources of funds, such as noninterest-bearing deposits and shareowners' equity.

We have established a comprehensive interest rate risk management policy, which is administered by management's Asset/Liability Management Committee ("ALCO"). The policy establishes limits of risk, which are quantitative measures of the percentage change in net interest income (a measure of net interest income at risk) and the fair value of equity capital (a measure of economic value of equity ("EVE") at risk) resulting from a hypothetical change in interest rates for maturities from one day to 30 years. We measure the potential adverse impacts that changing interest rates may have on our short-term earnings, long-term value, and liquidity by employing simulation analysis through the use of computer modeling. The simulation model captures optionality factors such as call features and interest rate caps and floors imbedded in investment and loan portfolio contracts. As with any method of gauging interest rate risk, there are certain shortcomings inherent in the interest rate modeling methodology used by us. When interest rates change, actual movements in different categories of interest-earning assets and interest-bearing liabilities, loan prepayments, and withdrawals of time and other deposits, may deviate significantly from assumptions used in the model. Finally, the methodology does not measure or reflect the impact that higher rates may have on adjustable-rate loan clients' ability to service their debts, or the impact of rate changes on demand for loan and deposit products.

We prepare a current base case and several alternative simulations, at least once per quarter, and report the analysis to the Board of Directors. In addition, more frequent forecasts may be produced when interest rates are particularly uncertain or when other business conditions so dictate.

Our interest rate risk management goal is to avoid unacceptable variations in net interest income and capital levels due to fluctuations in market rates. Management attempts to achieve this goal by balancing, within policy limits, the volume of floating-rate liabilities with a similar volume of floating-rate assets, by keeping the average maturity of fixed-rate asset and liability contracts reasonably matched, by maintaining our core deposits as a significant component of our total funding sources, and by adjusting pricing rates to market conditions on a continuing basis.

The balance sheet is subject to testing for interest rate shock possibilities to indicate the inherent interest rate risk. Average interest rates are shocked by plus or minus 100, 200, 300, and 400 basis points ("bp"), although we may elect not to use particular scenarios that we determined are impractical in a current rate environment. It is management's goal to structure the balance sheet so that net interest earnings at risk over a 12-month period and the economic value of equity at risk do not exceed policy guidelines at the various interest rate shock levels.



We augment our interest rate shock analysis with alternative external interest rate scenarios on a quarterly basis. These alternative interest rate scenarios may include non-parallel rate ramps.

*Analysis.* Measures of net interest income at risk produced by simulation analysis are indicators of an institution's short-term performance in alternative rate environments. These measures are typically based upon a relatively brief period, usually one year. They do not necessarily indicate the long-term prospects or economic value of the institution.

#### ESTIMATED CHANGES IN NET INTEREST INCOME <sup>(1)</sup>

Changes in Interest Rates	+400 bp	+300 bp	+200 bp	+100 bp	-100 bp
Policy Limit	-15.0%	-12.5%	-10.0%	-7.5%	-7.5%
June 30, 2016	10.7%	7.2%	4.1%	1.9%	-5.7%
March 31, 2016	11.1%	7.5%	4.1%	1.8%	-6.2%

The Net Interest Income at Risk position improved or was unchanged at the end of the second quarter of 2016 when compared to the prior quarter-end for all rate scenarios with the exception of rates up 300 bps and rates up 400 bps. The unfavorable change from the prior quarter-end in rates up 300 bps and 400 bps reflects lower levels of repricing assets, primarily overnight funds, while also funding loan growth and bond purchases. In addition, this analysis incorporates an instantaneous, parallel shock and assumes we move with market rates and do not lag our deposit rates. All measures of net interest income at risk are within our prescribed policy.

The measures of equity value at risk indicate our ongoing economic value by considering the effects of changes in interest rates on all of our cash flows, and discounting the cash flows to estimate the present value of assets and liabilities. The difference between these discounted values of the assets and liabilities is the economic value of equity, which, in theory, approximates the fair value of our net assets.

#### ESTIMATED CHANGES IN ECONOMIC VALUE OF EQUITY <sup>(1)</sup>

Changes in Interest Rates	+400 bp	+300 bp	+200 bp	+100 bp	-100 bp
Policy Limit	-30.0%	-25.0%	-20.0%	-15.0%	-15.0%
June 30, 2016	50.9%	40.5%	28.6%	15.5%	-36.8%
March 31, 2016	42.3%	33.6%	23.6%	12.8%	-31.3%

As of June 30, 2016, the economic value of equity in all rate scenarios versus the base case was more favorable than it was as of March 31, 2016, with the exception of the rates down 100 bps scenario. The EVE in the rates down 100 scenario is outside of the desired parameters as exposure to falling rates is more extreme due to the low level of current deposit costs and limited capacity to reduce those costs relative to comparable discount benchmarks used to value them. To bring this metric into compliance with our policy limits in the down 100 scenario would require the bank to extend its asset duration considerably, which we do not believe is prudent given the current historically low interest rate environment. Note that if the non-maturity deposit values in a rate down 100 bps scenario are assumed to remain unchanged from the flat rate scenario so as not to be valued above book value, EVE is more favorable and within compliance at 6.2%.

*(1) Down 200 and 300 bp scenarios have been excluded due to the current historically low interest rate environment.*

## LIQUIDITY AND CAPITAL RESOURCES

### Liquidity

In general terms, liquidity is a measurement of our ability to meet our cash needs. Our objective in managing our liquidity is to maintain our ability to meet loan commitments, purchase securities or repay deposits and other liabilities in accordance with their terms, without an adverse impact on our current or future earnings. Our liquidity strategy is guided by policies that are formulated and monitored by our ALCO and senior management, and which take into account the marketability of assets, the sources and stability of funding and the level of unfunded commitments. We regularly evaluate all of our various funding sources with an emphasis on accessibility, stability, reliability and cost-effectiveness. Our principal source of funding has been our client deposits, supplemented by our short-term and long-term borrowings, primarily from securities sold under repurchase agreements, federal funds purchased and

FHLB borrowings. We believe that the cash generated from operations, our borrowing capacity and our access to capital resources are sufficient to meet our future operating capital and funding requirements.

As of June 30, 2016, we have the ability to generate \$1.240 billion in additional liquidity through all of our available resources (this excludes \$221 million in overnight funds sold). In addition to primary borrowing outlets mentioned above, we also have the ability to generate liquidity by borrowing from the Federal Reserve Discount Window and through brokered deposits. We recognize the importance of maintaining liquidity and have developed a Contingency Liquidity Plan, which addresses various liquidity stress levels and our response and action based on the level of severity. We periodically test our credit facilities for access to the funds, but also understand that as the severity of the liquidity level increases that certain credit facilities may no longer be available. A liquidity stress test is completed on a quarterly basis based on events that could potentially occur at the Bank with results reported to ALCO, our Market Risk Oversight Committee, and the Board of Directors. The liquidity available to us is considered sufficient to meet our ongoing needs.

We view our investment portfolio primarily as a source of liquidity and have the option to pledge the portfolio as collateral for borrowings or deposits, and/or sell selected securities. The portfolio consists of debt issued by the U.S. Treasury, U.S. governmental and federal agencies, and municipal governments. The weighted average life of the portfolio is approximately 1.81 years, and as of June 30, 2016 had a net unrealized pre-tax gain of \$2.8 million in the available-for-sale portfolio.

Our average overnight funds position (defined as funds sold plus interest bearing deposits with other banks less funds purchased) was \$254.6 million during the second quarter of 2016 compared to \$286.2 million in the first quarter of 2016 and \$222.8 million in the fourth quarter of 2015. The decrease in net overnight funds compared to the first quarter of 2016 reflects an increase in both the investment and loan portfolios. The decline in interest bearing liabilities was nearly offset by the increase in noninterest bearing deposits. The increase relative to the fourth quarter of 2015 is primarily attributable to higher levels of all deposit products other than money market accounts and certificates of deposit, partially offset by growth in both the investment and loan portfolios.

Capital expenditures are estimated to approximate \$5.0 million over the next 12 months, which will consist primarily of office remodeling, office equipment/furniture, and technology purchases. Management believes that these capital expenditures will be funded with existing resources without impairing our ability to meet our on-going obligations.

## **Borrowings**

At June 30, 2016, advances from the FHLB consisted of \$26.9 million in outstanding debt consisting of 27 notes. During the first six months of 2016, the Bank made FHLB advance payments totaling approximately \$1.5 million, which includes paying off two advances totaling \$0.1 million. No additional FHLB advances were obtained. The FHLB notes are collateralized by a blanket floating lien on all of our 1-4 family residential mortgage loans, commercial real estate mortgage loans, and home equity mortgage loans.

We have issued two junior subordinated deferrable interest notes to our wholly owned Delaware statutory trusts. The first note for \$30.9 million was issued to CCBG Capital Trust I in November 2004. The second note for \$32.0 million was issued to CCBG Capital Trust II in May 2005. The interest payment for the CCBG Capital Trust I borrowing is due quarterly and adjusts quarterly to a variable rate of LIBOR plus a margin of 1.90%. This note matures on December 31, 2034. The interest payment for the CCBG Capital Trust II borrowing is due quarterly and adjusts annually to a variable rate of LIBOR plus a margin of 1.80%. This note matures on June 15, 2035. The proceeds of these borrowings were used to partially fund acquisitions. Under the terms of each junior subordinated deferrable interest note, in the event of default or if we elect to defer interest on the note, we may not, with certain exceptions, declare or pay dividends or make distributions on our capital stock or purchase or acquire any of our capital stock.

On April 12, 2016, we retired \$10 million in face value of trust preferred securities that were auctioned as part of a liquidation of a pooled collateralized debt obligation fund. The trust preferred securities were originally issued through CCBG Capital Trust I, a wholly-owned business trust subsidiary of CCBG. The \$10 million in trust preferred securities were retired, resulting in a commensurate reduction in our related floating rate junior subordinated note. Our winning bid equated to approximately 75% of the \$10 million par value, with the 25% discount resulting in a pre-tax gain of approximately \$2.5 million. We utilized internal resources and a \$3.75 million draw on a short-term borrowing facility to fund the repurchase.

## **Capital**

Equity capital was \$274.8 million as of June 30, 2016, compared to \$276.8 million as of March 31, 2016 and \$274.4 million as of December 31, 2015. Our leverage ratio was 9.88%, 10.34%, and 10.65%, respectively, as of these dates. Further, as of June 30, 2016, our risk-adjusted capital ratio was 16.44% compared to 17.20% and 17.25% at March 31, 2016 and December 31, 2015, respectively. Our common equity tier 1 ratio was 12.65% as of June 30, 2016 compared to 12.82% and 12.84% as of March 31, 2016 and December 31, 2015, respectively. All of our capital

ratios significantly exceed the threshold to be designated as “well-capitalized” under the Basel III capital standards. The reduction in our regulatory capital ratios in the second quarter of 2016 reflects the repurchase of common stock (~ 38 basis point impact) and the retirement of TRUPs (~ 50 basis point impact).

During the first six months of 2016, shareowners’ equity decreased \$0.5 million, or 0.3%, on an annualized basis. During this same period, shareowners’ equity was positively impacted by net income of \$5.6 million, stock compensation accretion of \$0.5 million, a \$1.7 million net increase in the unrealized gain on investment securities, and net adjustments totaling \$0.4 million related to transactions under our stock compensation plans. Shareowners’ equity was reduced by common stock dividends totaling \$1.4 million and the repurchase of common stock of \$6.3 million.

At June 30, 2016, our common stock had a book value of \$16.31 per diluted share compared to \$16.04 at March 31, 2016 and \$15.93 at December 31, 2015. Book value is impacted by changes in the amount of our net unrealized gain or loss on investment securities available-for-sale and changes to the amount of our unfunded pension liability both of which are recorded through other comprehensive income. At June 30, 2015, the net unrealized gain on investment securities available for sale was \$1.6 million and the amount of our unfunded pension liability was \$22.1 million.

In February 2014, our Board of Directors authorized the repurchase of up to 1,500,000 shares of our outstanding common stock. Repurchases may be made in the open market or in privately negotiated transactions; however, we are not obligated to repurchase any specified number of shares. During 2016, we have repurchased 435,000 shares at an average price of \$14.49 per share under the plan of which 427,000 shares were acquired in the second quarter of 2016.

#### **OFF-BALANCE SHEET ARRANGEMENTS**

We do not currently engage in the use of derivative instruments to hedge interest rate risks. However, we are a party to financial instruments with off-balance sheet risks in the normal course of business to meet the financing needs of our clients.

At June 30, 2016, we had \$403.5 million in commitments to extend credit and \$6.1 million in standby letters of credit. Commitments to extend credit are agreements to lend to a client so long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit are conditional commitments issued by us to guarantee the performance of a client to a third party. We use the same credit policies in establishing commitments and issuing letters of credit as we do for on-balance sheet instruments.

If commitments arising from these financial instruments continue to require funding at historical levels, management does not anticipate that such funding will adversely impact the Company's ability to meet its on-going obligations. In the event these commitments require funding in excess of historical levels, management believes current liquidity, advances available from the FHLB and the Federal Reserve, and investment security maturities provide a sufficient source of funds to meet these commitments.

## **CRITICAL ACCOUNTING POLICIES**

Our significant accounting policies are described in Note 1 to the Consolidated Financial Statements included in our 2015 Form 10-K. The preparation of our Consolidated Financial Statements in accordance with accounting principles generally accepted in the United States ("GAAP") and reporting practices applicable to the banking industry requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and to disclose contingent assets and liabilities. Actual results could differ from those estimates.

We have identified accounting for (i) the allowance for loan and lease losses, (ii) valuation of goodwill, and (iii) pension benefits as our most critical accounting policies and estimates in that they are important to the portrayal of our financial condition and results, and they require our subjective and complex judgment as a result of the need to make estimates about the effects of matters that are inherently uncertain. These accounting policies, including the nature of the estimates and types of assumptions used, are described throughout this Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations, and Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations included in our 2015 Form 10-K.

**TABLE I**  
**AVERAGE BALANCES & INTEREST**  
**RATES**

(Dollars in Thousands)	Three Months Ended June 30,						Six Months Ended June 30,		
	2016			2015			2016		
	Average Balances	Average Interest	Average Rate	Average Balances	Average Interest	Average Rate	Average Balances	Average Interest	
<b>Assets:</b>									
Loans <sup>(1)(2)</sup>	\$ 1,531,777	\$ 18,233	4.79%	\$ 1,473,954	\$ 18,285	4.98%	\$ 1,519,642	\$ 36,374	
Taxable Securities <sup>(2)</sup>	571,343	1,539	1.08	540,735	1,313	0.97	561,718	2,959	
Tax-Exempt Securities	90,030	325	1.44	76,191	219	1.15	92,490	657	
Funds Sold	254,627	318	0.50	237,132	151	0.26	270,397	680	
Total Earning Assets	2,447,777	20,415	3.35%	2,328,012	19,968	3.44%	2,444,247	40,670	
Cash & Due From Banks	46,605			52,473			47,220		
Allowance For Loan Losses	(14,254)			(16,070)			(14,127)		
Other Assets	287,726			306,286			288,460		
<b>TOTAL ASSETS</b>	<b>\$ 2,767,854</b>			<b>\$ 2,670,701</b>			<b>\$ 2,765,800</b>		
<b>Liabilities:</b>									
NOW Accounts	\$ 762,667	\$ 67	0.04%	\$ 761,388	\$ 64	0.03%	\$ 780,832	\$ 136	
Money Market Accounts	257,000	30	0.05	256,265	32	0.05	254,723	59	
Savings Accounts	291,210	36	0.05	253,808	31	0.05	284,477	70	
Other Time Deposits	170,837	78	0.19	189,213	132	0.28	173,948	167	
Total Interest Bearing Deposits	1,481,714	211	0.06	1,460,674	259	0.07	1,493,980	432	
Short-Term Borrowings	53,691	38	0.28	54,237	15	0.11	60,315	48	
Subordinated Note Payable	54,316	343	2.50	62,887	338	2.13	58,601	730	
Other Long-Term Borrowings	26,721	206	3.11	30,067	237	3.16	27,245	422	
Total Interest Bearing Liabilities	1,616,442	798	0.20%	1,607,865	849	0.21%	1,640,141	1,632	
Noninterest Bearing Deposits	794,839			717,725			773,596		
Other Liabilities	77,041			70,690			73,565		
<b>TOTAL LIABILITIES</b>	<b>2,488,322</b>			<b>2,396,280</b>			<b>2,487,302</b>		
<b>TOTAL SHAREOWNERS' EQUITY</b>	<b>279,532</b>			<b>274,421</b>			<b>278,498</b>		
<b>TOTAL LIABILITIES AND SHAREOWNERS' EQUITY</b>	<b>\$ 2,767,854</b>			<b>\$ 2,670,701</b>			<b>\$ 2,765,800</b>		
Interest Rate Spread			3.15%			3.23%			
Net Interest Income		\$ 19,617			\$ 19,119			\$ 39,038	
Net Interest Margin <sup>(3)</sup>			3.22%			3.29%			

<sup>(1)</sup>Average Balances include nonaccrual loans.

<sup>(2)</sup>Interest income includes the effects of taxable equivalent adjustments using a 35% tax rate.

<sup>(3)</sup>Taxable equivalent net interest income divided by average earnings assets.

**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

See “Market Risk and Interest Rate Sensitivity” in Management’s Discussion and Analysis of Financial Condition and Results of Operations, above, which is incorporated herein by reference. Management has determined that no additional disclosures are necessary to assess changes in information about market risk that have occurred since December 31, 2015.

**Item 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

As of June 30, 2016, the end of the period covered by this Form 10-Q, our management, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer each concluded that as of June 30, 2016, the end of the period covered by this Form 10-Q, we maintained effective disclosure controls and procedures.

**Changes in Internal Control over Financial Reporting**

Our management, including the Chief Executive Officer and Chief Financial Officer, has reviewed our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934). There have been no significant changes in our internal control over financial reporting during our most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

We are party to lawsuits arising out of the normal course of business. In management's opinion, there is no known pending litigation, the outcome of which would, individually or in the aggregate, have a material effect on our



consolidated results of operations, financial position, or cash flows.

**Item 1A. Risk Factors**

In addition to the other information set forth in this Quarterly Report, you should carefully consider the factors discussed in Part I, Item 1A. “Risk Factors” in our 2015 Form 10-K, as updated in our subsequent quarterly reports. The risks described in our 2015 Form 10-K are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

*Purchases of Equity Securities by the Issuer and Affiliated Purchasers*

The following table contains information about all purchases made by, or on behalf of, us and any affiliated purchaser (as defined in Rule 10b-18(a)(3) under the Exchange Act) of shares or other units of any class of our equity securities that is registered pursuant to Section 12 of the Exchange Act.

<b>Period</b>	<b>Total number of shares purchased</b>	<b>Average price paid per share</b>	<b>Total number of shares purchased as part of our share repurchase program<sup>(1)</sup></b>	<b>Maximum Number of shares that may yet be purchased under our share repurchase program</b>
April 1, 2016 to April 30, 2016	-	\$0.00	-	1,071,572
May 1, 2016 to May 31, 2016	5,016	\$14.49	5,016	1,066,556
June 1, 2016 to June 30, 2016	426,845	\$14.50	426,845	639,711
<b>Total</b>	<b>431,861</b>	<b>\$14.50</b>	<b>431,861</b>	<b>639,711</b>

(1) This balance represents the number of shares that were repurchased during the second quarter of 2016 through the Capital City Bank Group, Inc. Share Repurchase Program (the “Program”), which was approved on February 27, 2014 for a five year period, under which we were authorized to repurchase up to 1,500,000 shares of our common stock. The Program is flexible and shares are acquired from the public markets and other sources using free cash flow. No shares are repurchased outside of the Program.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosure**

None.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

(A) Exhibits

31.1 Certification of William G. Smith, Jr., Chairman, President and Chief Executive Officer of Capital City Bank Group, Inc., Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.

31.2 Certification of J. Kimbrough Davis, Executive Vice President and Chief Financial Officer of Capital City Bank Group, Inc., Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.

32.1 Certification of William G. Smith, Jr., Chairman, President and Chief Executive Officer of Capital City Bank Group, Inc., Pursuant to 18 U.S.C. Section 1350.

32.2 Certification of J. Kimbrough Davis, Executive Vice President and Chief Financial Officer of Capital City Bank Group, Inc., Pursuant to 18 U.S.C. Section 1350.

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101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

**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 Chief Financial Officer hereunto duly authorized.

CAPITAL CITY BANK GROUP, INC.

(Registrant)

/s/ J. Kimbrough Davis

J. Kimbrough Davis

Executive Vice President and Chief Financial  
Officer

(Mr. Davis is the Principal Financial Officer and  
has been duly authorized to sign on behalf of the  
Registrant)

Date: August 5, 2016

Exhibit Index

<u>Exhibit</u>	<u>Description</u>
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