

CAPITAL CITY BANK GROUP INC  
Form 10-Q  
November 08, 2013

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

**<sup>x</sup> QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**For the Quarterly Period Ended September 30, 2013**

**OR**

**<sup>o</sup> 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**  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

**217 North Monroe Street, Tallahassee, Florida 32301**  
(Address of principal executive office) (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 October 31, 2013, 17,339,821 shares of the Registrant's Common Stock, \$.01 par value, were outstanding.

**CAPITAL CITY BANK GROUP, INC.**

**QUARTERLY REPORT ON FORM 10-Q**

**FOR THE PERIOD ENDED SEPTEMBER 30, 2013**

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## 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, 2012 (the “2012 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;
- § our need and our ability to incur additional debt or equity financing;
- § the accuracy of our financial statement estimates and assumptions, including the estimate for our loan loss provision and deferred tax valuation allowance;
- § continued depression of the market value of the Company that could result in an impairment of goodwill;
- § 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;
- § legislative or regulatory changes, including the Dodd-Frank Act;
- § the strength of the United States economy in general and the strength of the local economies in which we conduct operations;
- § restrictions on our operations, including the inability to pay dividends without our regulators’ consent;
- § the effects of the health and soundness of other financial institutions, including the FDIC’s need to increase Deposit Insurance Fund assessments;
- § our ability to declare and pay dividends;
- § 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;
- § 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;
- § the effects of security breaches and computer viruses that may affect our computer systems;
- § 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 referenced 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. CONSOLIDATED FINANCIAL STATEMENTS****CAPITAL CITY BANK GROUP, INC.****CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

(Dollars in Thousands)	Unaudited September 30, 2013	December 31, 2012
<b>ASSETS</b>		
Cash and Due From Banks	\$51,136	\$66,238
Federal Funds Sold and Interest Bearing Deposits	358,869	443,494
Total Cash and Cash Equivalents	410,005	509,732
Investment Securities Available for Sale	271,838	296,985
Investment Securities Held to Maturity (fair value of \$97,415)	97,309	—
Total Investment Securities	369,147	296,985
Loans Held For Sale	13,822	14,189
Loans, Net of Unearned Income	1,417,842	1,507,113
Allowance for Loan Losses	(25,010 )	(29,167 )
Loans, Net	1,392,832	1,477,946
Premises and Equipment, Net	103,702	107,092
Goodwill	84,811	84,811
Other Intangible Assets	80	242
Other Real Estate Owned	53,018	53,426
Other Assets	87,055	89,561
Total Assets	\$2,514,472	\$2,633,984
<b>LIABILITIES</b>		
Deposits:		
Noninterest Bearing Deposits	\$626,114	\$609,235
Interest Bearing Deposits	1,390,772	1,535,761
Total Deposits	2,016,886	2,144,996
Short-Term Borrowings	51,918	47,435
Subordinated Notes Payable	62,887	62,887
Other Long-Term Borrowings	40,244	46,859
Other Liabilities	91,369	84,918
Total Liabilities	2,263,304	2,387,095



SHAREOWNERS' EQUITY

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; 17,336,278 and 17,232,380 shares issued and outstanding at September 30, 2013 and December 31, 2012, respectively	173	172
Additional Paid-In Capital	40,481	38,707
Retained Earnings	240,842	237,569
Accumulated Other Comprehensive Loss, Net of Tax	(30,328 )	(29,559 )
Total Shareowners' Equity	251,168	246,889
Total Liabilities and Shareowners' Equity	\$2,514,472	\$2,633,984

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

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

(Dollars in Thousands, Except Per Share Data)	Three Months		Nine Months	
	Ended September 30, 2013	2012	Ended September 30, 2013	2012
<b>INTEREST INCOME</b>				
Interest and Fees on Loans	\$19,264	\$21,274	\$59,127	\$64,638
Investment Securities:				
Taxable	571	692	1,739	2,216
Tax Exempt	146	106	392	316
Funds Sold	269	254	818	723
Total Interest Income	20,250	22,326	62,076	67,893
<b>INTEREST EXPENSE</b>				
Deposits	335	480	1,117	1,679
Short-Term Borrowings	46	71	189	127
Subordinated Notes Payable	339	372	1,020	1,126
Other Long-Term Borrowings	330	372	1,010	1,204
Total Interest Expense	1,050	1,295	3,336	4,136
<b>NET INTEREST INCOME</b>	19,200	21,031	58,740	63,757
Provision for Loan Losses	555	2,864	3,075	13,400
Net Interest Income After Provision For Loan Losses	18,645	18,167	55,665	50,357
<b>NONINTEREST INCOME</b>				
Deposit Fees	6,474	6,406	18,856	19,028
Bank Card Fees	2,715	2,616	8,130	8,171
Wealth Management Fees	2,130	1,686	5,946	5,363
Mortgage Banking Fees	869	978	2,880	2,690
Data Processing Fees	662	687	1,985	2,042
Other	1,456	1,202	3,946	3,773
Total Noninterest Income	14,306	13,575	41,743	41,067
<b>NONINTEREST EXPENSE</b>				
Compensation	16,158	15,510	49,544	48,470
Occupancy, Net	4,403	4,590	12,982	13,626
Intangible Amortization	46	108	162	323
Other Real Estate	2,148	2,603	7,440	9,528
Other	7,678	7,390	22,087	23,144
Total Noninterest Expense	30,433	30,201	92,215	95,091
<b>INCOME (LOSS) BEFORE INCOME TAXES</b>	2,518	1,541	5,193	(3,667 )
Income Tax Expense (Benefit)	927	420	1,920	(1,900 )

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NET INCOME (LOSS)	\$1,591	\$1,121	\$3,273	\$(1,767 )
BASIC NET INCOME (LOSS) PER SHARE	\$0.09	\$0.07	\$0.19	\$(0.10 )
DILUTED NET INCOME (LOSS) PER SHARE	\$0.09	\$0.07	\$0.19	\$(0.10 )
Average Basic Shares Outstanding	17,336	17,215	17,319	17,196
Average Diluted Shares Outstanding	17,396	17,228	17,381	17,196

*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)**

(Dollars in Thousands)	Three Months		Nine Months	
	Ended	Ended	Ended	Ended
	September 30,	September 30,	September 30,	September 30,
	2013	2012	2013	2012
NET INCOME (LOSS)	\$1,591	\$1,121	\$3,273	\$(1,767)
Other comprehensive income (loss), before tax:				
Change in net unrealized gain (loss)	459	(24 )	(1,149)	(754 )
Unrealized losses on securities transferred from available for sale to held to maturity	(516 )	—	(516 )	—
Amortization of unrealized losses on securities transferred from available for sale to held to maturity	(7 )	—	(7 )	—
Reclassification adjustment for impairment loss realized in net income	210	—	410	—
Other comprehensive income (loss), before tax	146	(24 )	(1,262)	(754 )
Deferred tax benefit related to other comprehensive income	(129 )	(10 )	(493 )	(286 )
Other comprehensive income (loss), net of tax	17	(14 )	(769 )	(468 )
TOTAL COMPREHENSIVE INCOME (LOSS)	\$1,608	\$1,107	\$2,504	\$(2,235)

*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 Outstanding	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss, Net of Taxes	Total
<i>(Dollars In Thousands, Except Share Data)</i>						
Balance, January 1, 2013	17,232,380	\$ 172	\$ 38,707	\$ 237,569	\$ (29,559 )	\$ 246,889
Net Income		—	—	3,273	—	3,273
Other Comprehensive Loss, Net of Tax		—	—	—	(769 )	(769 )
Stock Performance Plan Compensation		—	914	—	—	914
Issuance of Common Stock	103,898	1	860	—	—	861
Balance, September 30, 2013	17,336,278	\$ 173	\$ 40,481	\$ 240,842	\$ (30,328 )	\$ 251,168
Balance, January 1, 2012	17,160,274	\$ 172	\$ 37,838	\$ 237,461	\$ (23,529 )	\$ 251,942
Net Loss		—	—	(1,767 )	—	(1,767 )
Other Comprehensive Loss, Net of Tax		—	—	—	(468 )	(468 )
Stock Performance Plan Compensation		—	131	—	—	131
Issuance of Common Stock	62,883	—	524	—	—	524
Balance, September 30, 2012	17,223,157	\$ 172	\$ 38,493	\$ 235,694	\$ (23,997 )	\$ 250,362

*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)**

(Dollars in Thousands)	Nine Months Ended	
	September 30, 2013	2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net Income (Loss)	\$3,273	\$(1,767 )
Adjustments to Reconcile Net Income (Loss) to Cash Provided by Operating Activities:		
Provision for Loan Losses	3,075	13,400
Depreciation	4,830	5,087
Amortization of Premiums, Discounts, and Fees (net)	3,422	2,441
Amortization of Intangible Assets	162	323
Impairment Loss on Security	410	—
Net Decrease in Loans Held-for-Sale	367	4,698
Stock-Based Compensation	914	131
Deferred Income Taxes	1,802	(920 )
Loss on Disposal of Fixed Assets	18	—
Loss on Sales and Write-Downs of Other Real Estate Owned	4,042	5,504
Net Decrease in Other Assets	1,197	5,516
Net Increase in Other Liabilities	6,451	13,441
Net Cash Provided By Operating Activities	29,963	47,854
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Securities Held to Maturity:		
Purchases	(39,115 )	—
Payments, Maturities, and Calls	4,141	—
Securities Available for Sale:		
Purchases	(142,336)	(105,774)
Sales	—	805
Payments, Maturities, and Calls	99,708	120,614
Net Decrease in Loans	61,354	62,582
Proceeds From Sales of Other Real Estate Owned	17,397	17,963
Purchases of Premises and Equipment	(1,458 )	(3,099 )
Net Cash (Used In) Provided By Investing Activities	(309 )	93,091
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net Decrease in Deposits	(128,110)	(151,925)
Net Increase (Decrease) in Short-Term Borrowings	55	(8,168 )
Proceeds from Other Long-Term Borrowings	1,303	3,070
Repayment of Other Long-Term Borrowings	(3,490 )	(2,366 )
Issuance of Common Stock	861	524
Net Cash Used In Financing Activities	(129,381)	(158,865)

NET DECREASE IN CASH AND CASH EQUIVALENTS	(99,727 )	(17,920 )
Cash and Cash Equivalents at Beginning of Period	509,732	385,314
Cash and Cash Equivalents at End of Period	\$410,005	\$367,394
Supplemental Cash Flow Disclosures:		
Interest Paid	\$2,364	\$3,035
Income Taxes Paid (Net of Refunds Received)	\$(2,201 )	\$(3,881 )
Noncash Investing and Financing Activities:		
Transfer of Securities Available for Sale to Held to Maturity	\$62,488	\$—
Loans Transferred to Other Real Estate Owned	\$21,031	\$14,039
Transfer of Current Portion of Long-Term Borrowings	\$4,428	\$7,184

*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, (“CCB” or the “Bank” and together with the Company) 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, CCB. 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. Operating results for the three and nine-month periods ended September 30, 2013 are not necessarily indicative of the results that may be expected for the year ended December 31, 2013.

The consolidated statement of financial condition at December 31, 2012 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, 2012.

**NOTE 2 - INVESTMENT SECURITIES**



*Investment Portfolio Composition.* The amortized cost and related market value of investment securities were as follows:

	September 30, 2013				December 31, 2012			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Market Value	Amortized Cost	Unrealized Gain	Unrealized Losses	Market Value
<b>Available for Sale</b>								
U.S. Treasury	\$79,336	\$ 144	\$ 40	\$79,440	\$96,745	\$ 504	\$ —	\$97,249
U.S. Government Agency	72,263	142	218	72,187	51,468	221	25	51,664
States and Political Subdivisions	107,149	182	38	107,293	79,818	124	63	79,879
Mortgage-Backed Securities	2,700	204	—	2,904	56,217	805	40	56,982
Other Securities <sup>(1)</sup>	10,204	—	190	10,014	11,811	—	600	11,211
<b>Total</b>	<b>271,652</b>	<b>\$ 672</b>	<b>\$ 486</b>	<b>\$271,838</b>	<b>\$296,059</b>	<b>\$ 1,654</b>	<b>\$ 728</b>	<b>\$296,985</b>
<b>Held to Maturity</b>								
U.S. Treasury	\$14,949	\$ 43	\$ —	\$14,992	\$—	\$—	\$ —	\$—
U.S. Government Agency	8,155	4	—	8,159	—	—	—	—
States and Political Subdivisions	14,001	17	23	13,995	—	—	—	—
Mortgage-Backed Securities	60,204	118	53	60,269	—	—	—	—
Other Securities	—	—	—	—	—	—	—	—
<b>Total</b>	<b>\$97,309</b>	<b>\$ 182</b>	<b>\$ 76</b>	<b>\$97,415</b>	<b>\$—</b>	<b>\$—</b>	<b>\$ —</b>	<b>\$—</b>

<sup>(1)</sup> *Includes Federal Home Loan Bank and Federal Reserve Bank stock recorded at cost of \$5.2 million and \$4.8 million, respectively, at September 30, 2013 and \$6.4 million and \$4.8 million, respectively, at December 31, 2012.*

Securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax. The Company determines the appropriate classification of securities at the time of purchase. Securities with limited marketability, such as stock in the Federal Reserve Bank and the Federal Home Loan Bank, are carried at cost.

Securities with an amortized cost of \$211.1 million and \$152.3 million at September 30, 2013 and December 31, 2012, 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 other 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.

During the third quarter of 2013, the Company transferred certain securities from available for sale to held to maturity. Transfers of securities into the held to maturity categories from available for sale are made at fair value on the date of the transfer. The securities had an aggregate fair value of \$63.0 million with an aggregate net unrealized loss of \$523,000 on the date of the transfer. The net unamortized, unrealized loss on the transferred securities included in accumulated other comprehensive income in the accompanying balance sheet as of September 30, 2013 totaled \$516,000. This amount will be amortized out of accumulated other comprehensive income over the remaining life of the underlying securities as an adjustment of the yield on those securities. In addition, the Company purchased \$39.1 million in securities during the third quarter of 2013 that were classified as held to maturity.

*Maturity Distribution.* As of September 30, 2013, 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 since they are not due at a certain maturity date.

(Dollars in Thousands)	Available for Sale		Held to Maturity	
	Amortized Cost	Market Value	Amortized Cost	Market Value
Due in one year or less	\$96,446	\$96,655	\$8,272	\$8,272
Due after one through five years	104,986	105,042	28,833	28,874
No Maturity	10,204	10,014	—	—
U.S. Government Agency	57,316	57,223	—	—
Mortgage-Backed Securities	2,700	2,904	60,204	60,269
Total	\$271,652	\$271,838	\$97,309	\$97,415

*Other Than Temporarily Impaired Securities.* The following tables summarize the investment securities with unrealized losses aggregated by major security type and length of time in a continuous unrealized loss position:

(Dollars in Thousands)	Less Than	Greater Than	Total
	12 Months	12 Months	

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	Market Value	Unrealized Losses	Market Value	Unrealized Losses	Market Value	Unrealized Losses
<b>September 30, 2013</b>						
<b>Available for Sale</b>						
U.S. Government Agency	\$61,578	\$ 239	\$4,869	\$ 19	\$66,447	\$ 258
States and Political Subdivisions	9,022	37	2,461	1	11,483	38
Other Securities	—	—	190	190	190	190
Total	\$70,600	\$ 276	\$7,520	\$ 210	\$78,120	\$ 486
<b>Held to Maturity</b>						
States and Political Subdivisions	1,328	23	—	—	1,328	23
Mortgage-Backed Securities	32,568	53	—	—	32,568	53
Total	\$33,896	\$ 76	\$—	\$ —	\$33,896	\$ 76
<b>December 31, 2012</b>						
<b>Available for Sale</b>						
U.S. Government Agency	\$8,464	\$ 23	\$790	\$ 2	\$9,254	\$ 25
States and Political Subdivisions	30,302	55	5,028	8	35,330	63
Mortgage-Backed Securities	3,921	15	1,624	25	5,545	40
Other Securities	—	—	600	600	600	600
Total	\$42,687	\$ 93	\$8,042	\$ 635	\$50,729	\$ 728

Management evaluates securities for other than temporary impairment at least quarterly, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to: 1) the length of time and the extent to which the fair value has been less than amortized cost, 2) the financial condition and near-term prospects of the issuer, and 3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in cost. 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 September 30, 2013, the Company had securities of \$369.1 million of which \$271.8 million were classified as available for sale and \$97.3 million were classified as held to maturity. The available for sale portfolio maintained a net pre-tax unrealized loss of \$0.5 million at September 30, 2013 on securities totaling \$78.1 million. Approximately \$70.6 million of these securities, with an unrealized loss of \$0.3 million, have been in a loss position for less than 12 months. Approximately \$7.5 million of these securities, with an unrealized loss of approximately \$0.2 million have been in a loss position for greater than 12 months. These debt securities are in a loss position because they were acquired when the general level of interest rates was lower than that on September 30, 2013. 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 September 30, 2013. The Company holds one bank preferred stock issue for \$0.2 million that has also been in a loss position for greater than 12 months. The Company realized \$0.2 million in impairment during the third quarter of 2013 for this security and has realized \$0.4 million impairment during 2013. The Company will continue to closely monitor the fair value of this security and will realize further impairment as needed.

### NOTE 3 – LOANS, NET

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

(Dollars in Thousands)	September 30, 2013	December 31, 2012
Commercial, Financial and Agricultural	\$ 123,253	\$ 139,850
Real Estate - Construction	31,454	37,512
Real Estate - Commercial Mortgage	570,736	613,625
Real Estate - Residential <sup>(1)</sup>	311,031	321,986
Real Estate - Home Equity	230,212	236,263
Consumer	151,156	157,877
Loans, Net of Unearned Income	\$ 1,417,842	\$ 1,507,113

<sup>(1)</sup> Includes loans in process with outstanding balances of \$5.8 million and \$11.9 million at September 30, 2013 and December 31, 2012, respectively.

Net deferred fees included in loans were \$1.5 million and \$1.6 million at September 30, 2013 and December 31, 2012, respectively.

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:

(Dollars in Thousands)	September 30, 2013		December 31, 2012	
	Nonaccrual	90 + Days	Nonaccrual	90 + Days
Commercial, Financial and Agricultural	\$489	—	\$1,069	—
Real Estate - Construction	640	—	4,071	—
Real Estate - Commercial Mortgage	25,714	—	41,045	—
Real Estate - Residential	9,530	—	13,429	—
Real Estate - Home Equity	4,741	—	4,034	—
Consumer	568	—	574	—
Total Nonaccrual Loans	\$41,682	—	\$64,222	—

*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:

	30-59 DPD	60-89 DPD	90 + DPD	Total Past Due	Total Current	Total Loans
<i>(Dollars in Thousands)</i>						
September 30, 2013						
Commercial, Financial and Agricultural	\$324	\$58	\$ —	\$382	\$122,383	\$123,253
Real Estate - Construction	—	108	—	108	30,707	31,454
Real Estate - Commercial Mortgage	2,070	563	—	2,633	542,390	570,736
Real Estate - Residential	1,734	1,665	—	3,399	298,102	311,031
Real Estate - Home Equity	587	119	—	706	224,764	230,212
Consumer	1,021	178	—	1,199	149,386	151,156
Total Past Due Loans	\$5,736	\$2,691	\$ —	\$8,427	\$1,367,732	\$1,417,842

	30-59 DPD	60-89 DPD	90 + DPD	Total Past Due	Total Current	Total Loans
<i>(Dollars in Thousands)</i>						
December, 31, 2012						
Commercial, Financial and Agricultural	\$302	\$314	\$ —	\$616	\$138,165	\$139,850
Real Estate - Construction	375	—	—	375	33,066	37,512
Real Estate - Commercial Mortgage	1,090	583	—	1,673	570,907	613,625
Real Estate - Residential	2,788	1,199	—	3,987	304,570	321,986
Real Estate - Home Equity	711	487	—	1,198	231,031	236,263
Consumer	1,693	392	—	2,085	155,218	157,877
Total Past Due Loans	\$6,959	\$2,975	\$ —	\$9,934	\$1,432,957	\$1,507,113

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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 probable 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.

(Dollars in Thousands)	Commercial Financial, Agricultural	Real Estate Construction	Real Estate Mortgage	Commercial Real Estate Residential	Real Estate Home Equity	Consumer	Unallocated	Total
<b>Three Months Ended September 30, 2013</b>								
Beginning Balance	\$ 895	\$ 2,243	\$ 9,951	\$ 9,258	\$ 2,879	\$ 1,042	\$ 1,026	\$ 27,294
Provision for Loan Losses	(171 )	(237 )	(630 )	1,044	277	297	(25 )	555
Charge-Offs	(138 )	(278 )	(882 )	(1,178 )	(362 )	(674 )	—	(3,512 )
Recoveries	87	1	167	167	13	238	—	673
Net Charge-Offs	(51 )	(277 )	(715 )	(1,011 )	(349 )	(436 )	—	(2,839 )
Ending Balance	\$ 673	\$ 1,729	\$ 8,606	\$ 9,291	\$ 2,807	\$ 903	\$ 1,001	\$ 25,010
<b>Nine Months Ended September 30, 2013</b>								
Beginning Balance	\$ 1,253	\$ 2,856	\$ 11,081	\$ 8,678	\$ 2,945	\$ 1,327	\$ 1,027	\$ 29,167
Provision for Loan Losses	(345 )	(130 )	151	2,868	404	153	(26 )	3,075
Charge-Offs	(411 )	(998 )	(2,975 )	(2,914 )	(797 )	(1,321 )	—	(9,416 )
Recoveries	176	1	349	659	255	744	—	2,184
Net Charge-Offs	(235 )	(997 )	(2,626 )	(2,255 )	(542 )	(577 )	—	(7,232 )
Ending Balance	\$ 673	\$ 1,729	\$ 8,606	\$ 9,291	\$ 2,807	\$ 903	\$ 1,001	\$ 25,010
<b>Three Months Ended September 30, 2012</b>								
Beginning Balance	\$ 1,320	\$ 2,703	\$ 8,550	\$ 12,085	\$ 2,830	\$ 1,441	\$ 1,000	\$ 29,929
Provision for Loan Losses	572	329	1,788	(792 )	1,130	(130 )	(33 )	2,864
Charge-Offs	(331 )	(127 )	(512 )	(981 )	(834 )	(355 )	—	(3,140 )
Recoveries	53	9	34	76	15	382	—	569
Net Charge-Offs	(278 )	(118 )	(478 )	(905 )	(819 )	27	—	(2,571 )
Ending Balance	\$ 1,614	\$ 2,914	\$ 9,860	\$ 10,388	\$ 3,141	\$ 1,338	\$ 967	\$ 30,222
<b>Nine Months Ended September 30, 2012</b>								
Beginning Balance	\$ 1,534	\$ 1,133	\$ 10,660	\$ 12,518	\$ 2,392	\$ 1,887	\$ 911	\$ 31,035
Provision for Loan Losses	534	2,147	4,548	3,505	2,752	(142 )	56	13,400

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Charge-Offs	(657 )	(402 )	(5,562 )	(6,843 )	(2,152)	(1,635 )	—	(17,251)
Recoveries	203	36	214	1,208	149	1,228	—	3,038
Net Charge-Offs	(454 )	(366 )	(5,348 )	(5,635 )	(2,003)	(407 )	—	(14,213)
Ending Balance	\$ 1,614	\$ 2,914	\$ 9,860	\$ 10,388	\$ 3,141	\$ 1,338	\$ 967	\$ 30,222



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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.

(Dollars in Thousands)	Commercial Financial, Agricultural	Real Estate Construction	Real Estate Mortgage	Real Estate Commercial Residential	Real Estate Home Equity	Consumer	Unallocated	Total
September 30, 2013								
Period-end amount								
Allocated to:								
Loans Individually Evaluated for Impairment	\$ 218	\$ 124	\$ 5,045	\$ 2,184	\$ 508	\$ 31	\$ —	\$ 8,110
Loans Collectively Evaluated for Impairment	455	1,605	3,561	7,107	2,299	872	1,001	16,900
Ending Balance	\$ 673	\$ 1,729	\$ 8,606	\$ 9,291	\$ 2,807	\$ 903	\$ 1,001	\$ 25,010
December 31, 2012								
Period-end amount								
Allocated to:								
Loans Individually Evaluated for Impairment	\$ 210	\$ 714	\$ 6,641	\$ 2,778	\$ 546	\$ 32	\$ —	\$ 10,921
Loans Collectively Evaluated for Impairment	1,043	2,142	4,440	5,900	2,399	1,295	1,027	18,246
Ending Balance	\$ 1,253	\$ 2,856	\$ 11,081	\$ 8,678	\$ 2,945	\$ 1,327	\$ 1,027	\$ 29,167
September 30, 2012								
Period-end amount								
Allocated to:								
Loans Individually Evaluated for Impairment	\$ 453	\$ 700	\$ 5,566	\$ 3,604	\$ 858	\$ 18	\$ —	\$ 11,199
Loans Collectively Evaluated for Impairment	1,161	2,214	4,294	6,784	2,283	1,320	967	19,023
Ending Balance	\$ 1,614	\$ 2,914	\$ 9,860	\$ 10,388	\$ 3,141	\$ 1,338	\$ 967	\$ 30,222

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:

(Dollars in Thousands)	Commercial Financial, Agricultural	Real Estate Construction	Real Estate Mortgage	Real Estate Commercial Residential	Real Estate Home Equity	Consumer	Unallocated	Total
September 30, 2013								
Individually Evaluated for	\$ 3,546	\$ 773	\$ 57,820	\$ 20,894	\$ 3,977	\$ 416	\$ —	\$ 87,426

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Impairment Collectively Evaluated for Impairment Total	119,707 \$ 123,253	30,681 \$ 31,454	512,916 \$ 570,736	290,137 \$ 311,031	226,235 \$ 230,212	150,740 \$ 151,156	— \$ —	1,330,416 \$ 1,417,842
December 31, 2012								
Individually Evaluated for Impairment Collectively Evaluated for Impairment Total	\$ 2,325 137,525 \$ 139,850	\$ 4,232 33,280 \$ 37,512	\$ 74,650 538,975 \$ 613,625	\$ 23,030 298,956 \$ 321,986	\$ 3,858 232,405 \$ 236,263	\$ 687 157,190 \$ 157,877	\$ — — \$ —	\$ 108,782 1,398,331 \$ 1,507,113
September 30, 2012								
Individually Evaluated for Impairment Collectively Evaluated for Impairment Total	\$ 2,379 133,560 \$ 135,939	\$ 5,716 37,562 \$ 43,278	\$ 75,707 533,964 \$ 609,671	\$ 28,592 319,344 \$ 347,936	\$ 3,380 236,066 \$ 239,446	\$ 112 156,913 \$ 157,025	\$ — — \$ —	\$ 115,886 1,417,409 \$ 1,533,295

*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>	Unpaid Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Related Allowance
September 30, 2013				
Commercial, Financial and Agricultural	\$3,546	\$ 2,279	\$ 1,267	\$ 218
Real Estate - Construction	773	—	773	124
Real Estate - Commercial Mortgage	57,820	23,441	34,379	5,045
Real Estate - Residential	20,894	2,674	18,220	2,184
Real Estate - Home Equity	3,977	1,159	2,818	508
Consumer	416	96	320	31
Total	\$87,426	\$ 29,649	\$ 57,777	\$ 8,110
December 31, 2012				
Commercial, Financial and Agricultural	\$2,325	\$ 527	\$ 1,797	\$ 210
Real Estate - Construction	4,232	—	4,232	714
Real Estate - Commercial Mortgage	74,650	22,594	52,056	6,641
Real Estate - Residential	23,030	2,635	20,395	2,778
Real Estate - Home Equity	3,858	890	2,968	546
Consumer	687	123	565	32
Total	\$108,782	\$ 26,769	\$ 82,013	\$ 10,921

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

<i>(Dollars in Thousands)</i>	Three Months Ended September 30,				Nine Months Ended September 30,			
	2013		2012		2013		2012	
	Average Recorded Investment	Total Interest Income	Average Recorded Investment	Total Interest Income	Average Recorded Investment	Total Interest Income	Average Recorded Investment	Total Interest Income
Commercial, Financial and Agricultural	\$2,750	34	\$1,969	48	\$2,633	110	\$2,016	90
Real Estate - Construction	935	2	6,138	21	1,317	5	3,114	91
Real Estate - Commercial Mortgage	59,657	510	68,202	1,051	60,785	1,575	69,741	2,221
Real Estate - Residential	20,992	217	28,850	332	21,353	637	32,377	828
Real Estate - Home Equity	4,050	19	3,474	71	4,056	54	3,453	133

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Consumer	472	3	91	9	529	7	128	33
Total	\$88,856	785	\$108,724	1,532	\$90,673	2,388	\$110,829	3,396

*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. 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 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:

(Dollars in Thousands)	Commercial, Financial, Agriculture	Real Estate	Consumer	Total
September 30, 2013				
Special Mention	\$ 9,642	\$62,583	\$ 74	\$72,299
Substandard	4,057	121,772	1,448	127,277
Doubtful	—	914	—	914
Total Criticized Loans	\$ 13,699	\$ 185,269	\$ 1,522	\$ 200,490

(Dollars in Thousands)	Commercial, Financial, Agriculture	Real Estate	Consumer	Total
December 31, 2012				
Special Mention	\$ 4,380	\$54,938	\$ 142	\$59,460
Substandard	10,863	177,277	1,624	189,764
Doubtful	158	1,515	—	1,673
Total Criticized Loans	\$ 15,401	\$233,730	\$ 1,766	\$250,897

*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 defer cash payments required as part of the loan agreement through either a principal moratorium or extension of the loan term. 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:

(Dollars in Thousands)	September 30, 2013		December 31, 2012	
	Accruing	Nonaccruing	Accruing	Nonaccruing
Commercial, Financial and Agricultural	\$1,445	\$ 145	\$1,462	\$ 508
Real Estate - Construction	158	—	161	—
Real Estate - Commercial Mortgage	32,088	7,738	29,870	8,425
Real Estate - Residential	14,814	672	13,824	936
Real Estate - Home Equity	1,774	93	1,587	—
Consumer	413	—	570	10
Total TDRs	\$50,692	\$ 8,648	\$47,474	\$ 9,879





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

(Dollars in Thousands)	Three Months Ended September 30, 2013			Nine Months Ended September 30, 2013		
	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	—	\$ —	\$ —	4	\$ 294	\$ 337
Real Estate - Construction	—	—	—	—	—	—
Real Estate - Commercial Mortgage	3	4,264	4,250	12	9,385	9,403
Real Estate - Residential	6	581	642	16	1,757	1,856
Real Estate - Home Equity	2	85	85	8	429	427
Consumer	—	—	—	6	112	93
Total TDRs	11	\$ 4,930	\$ 4,977	46	\$ 11,977	\$ 12,116

(Dollars in Thousands)	Three Months Ended September 30, 2012			Nine Months Ended September 30, 2012		
	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	1	\$ 215	\$ 215	5	\$ 871	\$ 875
Real Estate - Construction	2	162	162	6	969	976
Real Estate - Commercial Mortgage	18	5,255	5,360	45	13,799	14,104
Real Estate - Residential	34	2,950	2,860	54	5,445	5,418
Real Estate - Home Equity	16	611	610	16	611	610
Consumer	57	568	591	59	586	635
Total TDRs	128	\$ 9,761	\$ 9,798	185	\$ 22,281	\$ 22,618

Loans modified as TDRs within the previous 12 months that have subsequently defaulted during the three and nine months ended September 30, 2013 and 2012 are presented in the table below.

(Dollars in Thousands)	Three Months Ended September 30, 2013		Nine Months Ended September 30, 2013	
	Number of Contracts	Post-Modified Recorded Investment	Number of Contracts	Post-Modified Recorded Investment
Commercial, Financial and Agricultural	—	\$ —	1	\$ 83
Real Estate - Commercial Mortgage	1	304	2	366

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Real Estate - Residential	5	445	7	728
Real Estate - Home Equity	1	50	1	50
Total TDRs	7	\$ 799	11	\$ 1,227

(Dollars in Thousands)	Three Months		Nine Months	
	Ended September 30, 2012		Ended September 30, 2012	
	Number of Post-Modified of Recorded Contracts	Investment	Number of Post-Modified of Recorded Contracts	Investment
Real Estate - Commercial Mortgage	2	\$ 282	4	\$ 1,721
Real Estate - Residential	4	751	7	1,710
Total TDRs	6	\$ 1,033	11	\$ 3,431

**NOTE 4 - INTANGIBLE ASSETS**

The Company had net intangible assets of \$84.9 million and \$85.1 million at September 30, 2013 and December 31, 2012, respectively. Intangible assets were as follows:

(Dollars in Thousands)	September 30, 2013		December 31, 2012	
	Gross Amount	Accumulated Amortization	Gross Amount	Accumulated Amortization
Core Deposit Intangibles	\$47,176	\$ 47,176	\$47,176	\$ 47,157
Goodwill	84,811	—	84,811	—
Customer Relationship Intangible	1,867	1,787	1,867	1,644
Total Intangible Assets	\$133,854	\$ 48,963	\$133,854	\$ 48,801

*Net Core Deposit Intangibles:* As of September 30, 2013, the Company's core deposit intangibles were fully amortized. At December 31, 2012, the Company had net core deposit intangibles of \$19,000. Amortization expense for the first nine months of 2013 and 2012 was \$19,000 and \$300,000, respectively.

*Goodwill:* As of September 30, 2013 and December 31, 2012, the Company had goodwill, net of accumulated amortization, of \$84.8 million. Goodwill is tested for impairment on an annual basis, or more often if impairment indicators exist. A goodwill impairment test consists of two steps. Step One compares the estimated fair value of the reporting unit to its carrying amount. If the carrying amount exceeds the estimated fair value, Step Two is performed by comparing the fair value of the reporting unit's implied goodwill to the carrying value of goodwill. If the carrying value of the reporting unit's goodwill exceeds the estimated fair value, an impairment charge is recorded equal to the excess.

As of September 30, 2013, the book value of the Company's equity exceeded its market capitalization, and as such, the Company performed goodwill impairment testing. The Step One test indicated that the carrying amount (including goodwill) of the Company's reporting unit exceeded its estimated fair value. The Step Two test indicated the estimated fair value of our reporting unit's implied goodwill exceeded its carrying amount. Based on the results of the Step Two analysis, the Company concluded that goodwill was not impaired as of September 30, 2013. The Company will continue to evaluate goodwill for impairment as defined by ASC Topic 350.

*Other:* As of September 30, 2013 and December 31, 2012, the Company had a customer relationship intangible asset, net of accumulated amortization, of \$80,000 and \$223,000, respectively. This intangible asset was recorded as a result of the acquisition of trust customer relationships. Amortization expense for the first nine months of 2013 and 2012 was approximately \$143,000. The Company's customer relationship intangible asset will be fully amortized by February 2014.

**NOTE 5 - DEPOSITS**

The composition of the Company's interest bearing deposits was as follows:

(Dollars in Thousands)	September 30, 2013	December 31, 2012
NOW Accounts	\$668,240	\$842,435
Money Market Accounts	283,338	267,766
Savings Deposits	211,174	184,541
Other Time Deposits	228,020	241,019
Total Interest Bearing Deposits	\$1,390,772	\$1,535,761

**NOTE 6 - 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 costs for the Company’s qualified benefit pension plan were as follows:

(Dollars in Thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Service Cost	\$1,750	\$1,599	\$5,250	\$4,797
Interest Cost	1,392	1,397	4,175	4,190
Expected Return on Plan Assets	(1,843)	(1,698)	(5,529)	(5,095)
Prior Service Cost Amortization	79	90	237	270
Net Loss Amortization	1,079	847	3,237	2,543
Net Periodic Cost	\$2,457	\$2,235	\$7,370	\$6,705
Discount Rate	4.25 %	5.00 %	4.25 %	5.00 %
Long-Term Rate of Return on Assets	8.00 %	8.00 %	8.00 %	8.00 %

The components of the net periodic benefit costs for the Company’s SERP were as follows:

(Dollars in Thousands)	Three Months		Nine Months	
	Ended		Ended September	
	September 30,		30,	
	2013	2012	2013	2012
Interest Cost	\$34	\$35	\$103	\$105
Prior Service Cost Amortization	47	47	140	142
Net Gain Amortization	(59 )	(92 )	(178)	(277)
Net Periodic Cost (Benefit)	\$22	\$(10 )	\$65	\$(30 )
Discount Rate	4.25 %	5.00 %	4.25 %	5.00 %

**NOTE 7 - 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:

(Dollars in Thousands)	September 30, 2013			December 31, 2012		
	Fixed	Variable	Total	Fixed	Variable	Total
Commitments to Extend Credit <sup>(1)</sup>	\$34,891	\$248,916	\$283,807	\$48,618	\$245,087	\$293,705
Standby Letters of Credit	11,307	—	11,307	11,249	—	11,249
Total	\$46,198	\$248,916	\$295,114	\$59,867	\$245,087	\$304,954

(1) *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 has asserted that its 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.

In July 2012, Visa and MasterCard International entered into a memorandum of understanding to enter into a settlement agreement to resolve the aforementioned Covered Litigation matter. Visa's share of the claim is to be paid from the litigation reserve account. Subsequent to the memorandum of understanding, Visa increased the litigation reserve by \$150 million and revised the conversion ratio for the Class B shares resulting in a \$56,000 payment by the Company under the swap contract. The Company does not expect to make any additional payments to the counterparty other than certain fixed charges included in the liability, which are payable quarterly in the range of approximately \$25,000 to \$50,000 until the settlement is finalized. Conversion ratio payments and ongoing fixed quarterly charges are reflected in earnings in the period incurred.

## NOTE 8 – 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 are reported at fair value utilizing Level 1 inputs. All 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 fairly generic and 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 an internally developed estimate of the exposure based upon probability-weighted potential Visa litigation losses and related carrying cost obligations required under the contract.

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

(Dollars in Thousands)	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
September 30, 2013				
Securities Available for Sale:				
U.S. Treasury	\$79,440	\$—	\$ —	\$79,440
U.S. Government Agency States and Political Subdivisions	—	72,187	—	72,187
Mortgage-Backed Securities	—	107,293	—	107,293
Federal Reserve and FHLB Stock	—	2,904	—	2,904
	—	10,014	—	10,014
December 31, 2012				
Securities Available for Sale:				
U.S. Treasury	\$97,249	\$—	\$ —	\$97,249
U.S. Government Agency State and Political Subdivisions	—	51,664	—	51,664
Mortgage-Backed Securities	—	79,879	—	79,879
Federal Reserve and FHLB Stock	—	56,982	—	56,982
	—	11,211	—	11,211

### **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 \$38.6 million with a valuation allowance of \$3.9 million at September 30, 2013 and \$63.1 million and \$7.1 million, respectively, at December 31, 2012.

*Loans Held for Sale.* Loans held for sale were \$13.8 million and \$14.2 million as of September 30, 2013 and December 31, 2012, respectively. 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 nine months of 2013, 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 will 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 volatility of the real estate market, and judgment and estimation involved in the real estate valuation process. Foreclosed assets measured at fair value upon initial recognition totaled \$21.0 million during the nine months ended September 30, 2013. The Company disposed of \$18.5 million in foreclosed assets, recognized subsequent write-downs totaling \$2.8 million for properties that were re-valued, and realized miscellaneous adjustments totaling \$0.1 million during the nine months ended September 30, 2013. The carrying value of foreclosed assets was \$53.0 million at September 30, 2013 and \$53.4 million at December 31, 2012.

### **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:

(Dollars in Thousands)	September 30, 2013			
	Carrying Value	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
<b>ASSETS:</b>				
Cash	\$51,136	\$51,136	\$—	\$—
Short-Term Investments	358,869	358,869	—	—
Investment Securities Available for Sale	271,838	79,440	192,398	—
Investment Securities Held to Maturity	97,309	14,992	82,423	—
Loans Held for Sale	13,822	—	13,822	—
Loans, Net of Allowance for Loan Losses	1,392,832	—	—	1,291,155
<b>LIABILITIES:</b>				
Deposits	\$2,016,886	\$—	\$2,017,412	\$—
Short-Term Borrowings	51,918	—	51,465	—
Subordinated Notes Payable	62,887	—	62,891	—
Long-Term Borrowings	40,244	—	41,937	—

(Dollars in Thousands)	December 31, 2012			
	Carrying Value	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
<b>ASSETS:</b>				
Cash	\$66,238	\$66,238	\$—	\$—
Short-Term Investments	443,494	443,494	—	—
Investment Securities Available for Sale	296,985	97,249	199,736	—
Loans Held for Sale	14,189	—	14,189	—
Loans, Net of Allowance for Loan Losses	1,477,946	—	—	1,370,056
<b>LIABILITIES:</b>				
Deposits	\$2,144,996	\$—	\$2,145,547	\$—
Short-Term Borrowings	47,435	—	46,503	—
Subordinated Notes Payable	62,887	—	62,896	—
Long-Term Borrowings	46,859	—	50,003	—

All non-financial instruments are excluded from the above table. The disclosures also do not include certain intangible assets such as client relationships, deposit base intangibles and goodwill. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

**NOTE 9 – OTHER COMPREHENSIVE INCOME (LOSS)**

The following is a summary of the activity within other comprehensive income and the amounts allocated to accumulated other comprehensive income at the end of each reporting period. The reclassification adjustment related to other than temporary impairment on securities available for sale was included in other expense in the accompanying consolidated statements of operations.

(Dollars in Thousands)	Three Months Ended September 30, 2013			Nine Months Ended September 30, 2013		
	Before Tax Amount	Expense (Benefit)	Net of Tax Amount	Before Tax Amount	Expense (Benefit)	Net of Tax Amount
Investment Securities:						
Change in net unrealized gain (loss)	\$459	\$ 169	\$ 290	\$(1,149)	\$(449 )	\$(700 )
Unrealized losses on securities transferred from available for sale to held to maturity	(516)	(200 )	(316 )	(516 )	(200 )	(316 )
Amortization of unrealized losses on securities transferred from available for sale to held to maturity	(7 )	(2 )	(5 )	(7 )	(2 )	(5 )
Reclassification adjustment for impairment loss realized in net income	210	162	48	410	158	252
Total other comprehensive income (loss)	\$146	\$(129 )	\$ 17	\$(1,262)	\$(493 )	\$(769 )

(Dollars in Thousands)	Three Months Ended September 30, 2012			Nine Months Ended September 30, 2012		
	Before Tax Amount	Expense (Benefit)	Net of Tax Amount	Before Tax Amount	Expense (Benefit)	Net of Tax Amount
Investment Securities:						
Change in net unrealized gain	\$(24)	\$(10 )	\$(14 )	\$(754)	\$(286 )	\$(468 )
Total other comprehensive loss	\$(24)	\$(10 )	\$(14 )	\$(754)	\$(286 )	\$(468 )

Amounts allocated to accumulated other comprehensive loss, net of tax, were as follows:

(Dollars in Thousands)	Securities Available for Sale	Retirement Plans	Accumulated Other Comprehensive Loss, Net of Taxes
Balance, January 1, 2013	\$ 573	\$(30,132 )	\$(29,559 )

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Other comprehensive loss before reclassifications	(1,021 )	—	(1,021 )
Amount reclassified from accumulated other comprehensive loss	252	—	252
Net other comprehensive loss during the period	(769 )	—	(769 )
Balance, September 30, 2013	\$(196 )	\$(30,132 )	\$( 30,328 )
Balance, January 1, 2012	\$ 1,064	\$(24,593 )	\$( 23,529 )
Other comprehensive loss	(468 )	—	(468 )
Net other comprehensive loss during the period	(468 )	—	(468 )
Balance, September 30, 2012	\$ 596	\$(24,593 )	\$( 23,997 )

**NOTE 10 – ACCOUNTING STANDARDS UPDATES**

*ASU 2013-02 “Comprehensive Income (Topic 220) – Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income.”* ASU 2013-02 requires an entity to separately present the amount reclassified out of accumulated other comprehensive income (“AOCI”) for each component of AOCI and to disclose, for each affected line item in the income statement, the amount of AOCI that has been reclassified into that line item. If the reclassification doesn’t go directly to an income statement line it is acceptable to cross reference that amount to another footnote that provides the required disclosure. ASU 2013-02 became effective for the Company on January 1, 2013 and did not have a significant impact on the Company’s financial statements.

## **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 2013 compares with prior years. Throughout this section, Capital City Bank Group, Inc., and subsidiaries, collectively, are referred to as “CCBG,” “Company,” “we,” “us,” or “our.”

The following discussion should be read in conjunction with the condensed consolidated financial statements and notes thereto included in this Quarterly Report on Form 10-Q.

### **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,” 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 2012 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 bank 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 63 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 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 service charges on deposit accounts, asset management fees, retail securities brokerage fees, mortgage banking fees, bank card fees, and data processing fees. Since 2009, an elevated level of other real estate owned has had a significant impact on our profitability due to property valuation adjustments, carrying costs, and losses from the sale of properties.

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 2012 Form 10-K.

**SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)**

(Dollars in Thousands, Except Per Share Data)	2013				2012				2011
	Third	Second	First	Fourth	Third	Second	First	Fourth	
<b>Summary of Operations:</b>									
Interest Income	\$20,250	\$20,698	\$21,128	\$21,787	\$22,326	\$22,437	\$23,130	\$22,811	
Interest Expense	1,050	1,103	1,183	1,232	1,295	1,372	1,469	1,481	
Net Interest Income	19,200	19,595	19,945	20,555	21,031	21,065	21,661	21,330	
Provision for Loan Losses	555	1,450	1,070	2,766	2,864	5,743	4,793	7,100	
Net Interest Income After Provision for Loan Losses	18,645	18,145	18,875	17,789	18,167	15,322	16,868	14,230	
Noninterest Income	14,306	13,849	13,588	14,118	13,575	13,906	13,586	13,511	
Noninterest Expense	30,433	30,582	31,200	29,468	30,201	32,293	32,597	33,000	
Income (Loss) Before Income Taxes	2,518	1,412	1,263	2,439	1,541	(3,065 )	(2,143 )	(2,259 )	
Income Tax Expense (Benefit)	927	569	424	564	420	(1,339 )	(981 )	(1,000 )	
Net Income (Loss)	\$1,591	\$843	\$839	\$1,875	\$1,121	\$(1,726 )	\$(1,162 )	\$(500 )	
Net Interest Income (FTE)	\$19,355	\$19,744	\$20,079	\$20,697	\$21,179	\$21,219	\$21,833	\$21,833	
<b>Per Common Share:</b>									
Net Income (Loss) Basic	\$0.09	\$0.05	\$0.05	\$0.11	\$0.07	\$(0.10 )	\$(0.07 )	\$(0.07 )	
Net Income (Loss) Diluted	0.09	0.05	0.05	0.11	0.07	(0.10 )	(0.07 )	(0.07 )	
Dividends Declared	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
Diluted Book Value	14.44	14.36	14.35	14.31	14.54	14.48	14.60	14.54	
<b>Market Price:</b>									
High	13.08	12.64	12.54	11.91	10.96	8.73	9.91	11.00	
Low	11.06	10.12	10.95	9.04	7.00	6.35	7.32	9.00	
Close	11.78	11.53	12.35	11.37	10.64	7.37	7.45	9.00	

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Selected  
Average  
Balances:

Loans, Net	\$1,436,039	\$1,456,904	\$1,496,432	\$1,518,280	\$1,541,262	\$1,570,827	\$1,596,480	\$1,622,137
Earning Assets	2,201,390	2,206,694	2,240,889	2,178,946	2,209,166	2,262,847	2,268,307	2,321,864
Total Assets	2,558,395	2,564,528	2,598,680	2,534,011	2,566,239	2,624,417	2,636,907	2,698,728
Deposits	2,059,498	2,067,647	2,102,967	2,051,099	2,075,482	2,135,653	2,161,388	2,217,141
Shareowners' Equity	251,617	250,485	249,557	253,017	251,746	252,644	254,447	256,250
Common Equivalent Average Shares:								
Basic	17,336	17,319	17,302	17,229	17,215	17,192	17,181	17,170
Diluted	17,396	17,355	17,309	17,256	17,228	17,192	17,181	17,170

Performance  
Ratios:

Return on Average Assets	0.25	%	0.13	%	0.13	%	0.29	%	0.17	%	(0.26)	)%	(0.18)	)%	(0.14)	)%
Return on Average Equity	2.51		1.35		1.36		2.95		1.77		(2.75)	)	(1.84)	)	(0.97)	)
Net Interest Margin (FTE)	3.49		3.59		3.64		3.78		3.82		3.77		3.87		4.00	
Noninterest Income as % of Operating Revenue	42.82		41.68		40.62		40.81		39.31		39.88		38.64		38.97	
Efficiency Ratio	90.42		91.07		92.67		84.68		86.89		91.18		92.04		93.17	

Asset Quality:

Allowance for Loan Losses	\$25,010	\$27,294	\$27,803	\$29,167	\$30,222	\$29,929	\$31,217	\$32,500								
Allowance for Loan Losses to Loans	1.75	%	1.89	%	1.90	%	1.93	%	1.97	%	1.93	%	1.98	%	2.00	%
Nonperforming Assets ("NPAs")	94,700	96,653	103,869	117,648	127,247	132,829	136,826	141,826								
NPAs to Total Assets	3.77		3.77		3.99		4.47		5.10		5.02		5.14		5.29	
NPAs to Loans + OREO	6.38		6.44		6.81		7.47		8.02		8.23		8.36		8.50	
Allowance to Non-Performing Loans	60.00		65.66		61.17		45.42		40.80		40.03		39.65		38.70	
Net Charge-Offs to Average Loans	0.78		0.54		0.66		1.00		0.66		1.80		1.16		1.16	

Capital Ratios:

	15.60	%	15.36	%	14.95	%	14.35	%	14.43	%	14.17	%	14.17	%	13.97	%
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Tier 1 Capital Ratio								
Total Capital Ratio	16.97	16.73	16.32	15.72	15.80	15.54	15.54	15.54
Tangible Capital Ratio	6.84	6.64	6.49	6.35	6.86	6.40	6.42	6.42
Leverage Ratio	10.16	10.07	9.81	9.90	9.83	9.60	9.71	9.71

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## FINANCIAL OVERVIEW

A summary overview of our financial performance is provided below.

### Results of Operations

- ◆ Net income of \$1.6 million, or \$0.09 per diluted share, for the third quarter of 2013 compared to net income of \$0.8 million, or \$0.05 per diluted share, in the second quarter of 2013, and net income of \$1.1 million, or \$0.07 per diluted share for the third quarter of 2012. For the nine month period ended September 30, 2013, we realized net income of \$3.3 million, or \$0.19 per diluted share, compared to a net loss of \$1.8 million, or \$0.10 per diluted share, for the comparable period of 2012.
- ◆ Total credit costs (loan loss provision plus other real estate owned (“OREO”) costs) were \$2.7 million, \$3.9 million, and \$5.5 million for the quarters ended September 30, 2013, June 30, 2013, and September 30, 2012, respectively. Total credit costs for the nine month period of 2013 were \$10.5 million compared to \$22.9 million for the same period of 2012. The decreases reflect continued improvement in credit quality trends and reduced OREO costs.
- ◆ Tax equivalent net interest income for the third quarter of 2013 was \$19.4 million compared to \$19.7 million for the second quarter of 2013 and \$21.2 million for the third quarter of 2012. For the nine month period, tax equivalent net interest income totaled \$59.2 million compared to \$64.3 million in 2012. The reduction from all prior periods was due to a reduction in loan income primarily attributable to declining loan balances and the impact of the extended low interest rate environment which has depressed our loan and investment yields.
- ◆ Noninterest income for the third quarter of 2013 totaled \$14.3 million, an increase of \$0.5 million, or 3.3%, over the second quarter of 2013 and \$0.7 million, or 5.4%, over the third quarter of 2012. The increase over the second quarter of 2013 was driven by higher deposit fees of \$0.3 million and wealth management fees of \$0.2 million. The increase over the third quarter of 2012 was driven by higher wealth management fees. For the nine month period, noninterest income totaled \$41.7 million, a \$0.7 million increase over the same period in 2012 primarily due to higher wealth management fees of \$0.6 million and mortgage banking fees of \$0.2 million.
- ◆ Noninterest expense for the third quarter of 2013 totaled \$30.4 million, a decrease of \$0.1 million, or 0.5%, from the second quarter of 2013 attributable to lower compensation expense of \$0.5 million, partially offset by higher occupancy expense of \$0.3 million and other expense of \$0.1 million. Compared to the third quarter of 2012, noninterest expense increased by \$0.2 million, or 0.8%, attributable to higher compensation expense of \$0.6 million that was partially offset by lower occupancy expense of \$0.2 million and other expense of \$0.2 million. For the nine month period, noninterest expense totaled \$92.2 million, a decrease of \$2.9 million, or 3.0%, from the same period of 2012 attributable to lower occupancy expense of \$0.6 million and other expense of \$3.3 million, partially offset by higher compensation expense of \$1.1 million.

### Financial Condition

- ◆ Average earning assets were \$2.201 billion for the third quarter of 2013, a decrease of \$5.3 million, or 0.2%, from the second quarter of 2013 and an increase of \$22.4 million, or 1.0%, over the fourth quarter of 2012. The change in earning assets from the second quarter of 2013 reflected a decline in the overnight funds position primarily as a result of a lower level of deposits. The increase compared to the fourth quarter of 2012 primarily reflected an expected seasonal increase in public fund deposits.
- ◆ Nonperforming assets totaled \$94.7 million at September 30, 2013, a decrease of \$2.0 million from June 30, 2013 driven by a decline in our OREO balance as nonaccrual loans remained flat. Nonperforming assets have declined by \$22.9 million from December 31, 2012, due to a faster pace of nonaccrual loan resolutions and continued progress in disposing of OREO properties. Nonperforming assets represented 3.77% of total assets at September 30, 2013 compared to 3.77% at June 30, 2013 and 4.47% at December 31, 2012.
- ◆ As of September 30, 2013, we were well-capitalized with a risk based capital ratio of 16.97% and a tangible common equity ratio of 6.84% compared to 16.73% and 6.64%, respectively, at June 30, 2013 and 15.72% and 6.35%, respectively, at December 31, 2012.

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

For the third quarter of 2013, we realized net income of \$1.6 million, or \$0.09 per diluted share, compared to net income of \$0.8 million, or \$0.05 per diluted share, for the second quarter of 2013, and a net income of \$1.1 million, or \$0.07 per diluted share, for the third quarter of 2012. For the nine month period ended September 30, 2013, we realized net income of \$3.3 million, or \$0.19 per diluted share, compared to a net loss of \$1.8 million, or \$0.10 per diluted share, for the same period in 2012.

Compared to the second quarter of 2013, performance reflected a lower loan loss provision of \$0.9 million, an increase in noninterest income of \$0.5 million and a decrease in noninterest expense of \$0.1 million, partially offset by lower net interest income of \$0.4 million and higher income taxes of \$0.3 million.

Compared to the third quarter of 2012, the increase in earnings was primarily due to a lower loan loss provision of \$2.3 million and higher noninterest income of \$0.7 million, partially offset by lower net interest income of \$1.8 million, an increase in noninterest expense of \$0.2 million and higher income taxes of \$0.5 million.

The increase in earnings for the nine month period is attributable to a lower loan loss provision of \$10.3 million, an increase in noninterest income of \$0.7 million and a decrease in noninterest expense of \$2.9 million, partially offset by a reduction in net interest income of \$5.0 million and higher income taxes of \$3.8 million.

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

(Dollars in Thousands, except per share data)	Three Months Ended			Nine Months Ended	
	Sept 30, 2013	June 30, 2013	Sept 30, 2012	Sept 30, 2013	Sept 30, 2012
Interest Income	\$20,250	\$20,698	\$22,326	\$62,076	\$67,893
Taxable Equivalent Adjustments	155	149	148	438	474
Total Interest Income (FTE)	20,405	20,847	22,474	62,514	68,367
Interest Expense	1,050	1,103	1,295	3,336	4,136
Net Interest Income (FTE)	19,355	19,744	21,179	59,178	64,231
Provision for Loan Losses	555	1,450	2,864	3,075	13,400
Taxable Equivalent Adjustments	155	149	148	438	474
Net Interest Income After provision for Loan Losses	18,645	18,145	18,167	55,665	50,357

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Noninterest Income	14,306	13,849	13,575	41,743	41,067
Noninterest Expense	30,433	30,582	30,201	92,215	95,091
Income (Loss) Before Income Taxes	2,518	1,412	1,541	5,193	(3,667 )
Income Tax Expense (Benefit)	927	569	420	1,920	(1,900 )
Net Income (Loss)	\$1,591	\$843	\$1,121	\$3,273	\$(1,767 )
Basic Net Income (Loss) Per Share	\$0.09	\$0.05	\$0.07	\$0.19	\$(0.10 )
Diluted Net Income (Loss) Per Share	\$0.09	\$0.05	\$0.07	\$0.19	\$(0.10 )

**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 44.

Tax equivalent net interest income for the third quarter of 2013 was \$19.4 million compared to \$19.7 million for the second quarter of 2013 and \$21.2 million for the third quarter of 2012. For the first nine months of 2013, tax equivalent net interest income totaled \$59.2 million compared to \$64.2 million for the same period of 2012.

The declines of \$0.4 million and \$1.8 million in tax equivalent net interest income from the second quarter of 2013 and third quarter of 2012, respectively, were due to a reduction in loan income primarily attributable to declining loan balances and continued unfavorable asset repricing, partially offset by a reduction in interest expense and a lower level of foregone interest on loans. The lower interest expense is attributable to favorable repricing on FHLB advances and certificates of deposit, which reflected both lower balances and favorable repricing.



Tax equivalent interest income for the third quarter of 2013 was \$20.4 million compared to \$20.8 million for the second quarter of 2013 and \$22.5 million for the third quarter of 2012. The decrease when compared to both periods was specifically attributable to the shift in earning asset mix and lower yields. The declining loan portfolio has resulted in the higher yielding earning assets being replaced with lower yielding federal funds or investment securities. Additionally, low yields on new loan and investment production and loan portfolio repricing continue to unfavorably affect net interest income.

Interest expense for the third quarter of 2013 was \$1.0 million compared to \$1.1 million for the second quarter of 2013 and \$1.3 million for the third quarter in 2012. The lower cost of funds when compared to both periods was a result of continued rate reductions on all deposit products except money markets and savings accounts and the FHLB advance favorable repricing. The rate reductions on deposits reflected our response to a historically low interest rate environment and desire to continue our focus on core banking relationships.

The net interest margin for the third quarter of 2013 was 3.49%, a decrease of ten basis points from the second quarter of 2013 and a decline of 33 basis points from the third quarter of 2012. Year-to-date net interest margin of 3.57% declined 24 basis points from the comparable period in 2012. The decrease in the margin for all comparable periods was attributable to the shift in our earning asset mix and unfavorable asset repricing, partially offset by a lower average cost of funds.

Pressure on net interest income continues primarily as a result of the declining loan portfolio and the low rate environment. Loans have declined by approximately \$102 million since the third quarter of 2012. The low rate environment, although favorable to the repricing of deposits, continues to negatively impact our loan and investment portfolios. Increased lending competition in all markets has also unfavorably impacted the pricing for loans. We believe that lowering our cost of funds, to the extent we can, and continuing to shift the mix of our deposits will help to partially mitigate the unfavorable impact of weak loan demand and repricing, although the impact is expected to be minimal. Given the unfavorable asset repricing and low rate environment, we anticipate continued pressure on the net interest margin for at least the remainder of 2013 and into 2014.

Our current strategy, as well as our historic strategy, is to not accept greater interest rate risk by reaching further out on the curve for yield, particularly given the fact that short-term rates are at historical lows. 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. Although this strategy has unfavorably impacted our net interest margin in the current environment, historically this strategy has consistently resulted in our net interest margins significantly exceeding those in our peer group comparisons.

### **Provision for Loan Losses**

The provision for loan losses for the third quarter of 2013 was \$0.6 million compared to \$1.4 million in the second quarter of 2013 and \$2.9 million for the third quarter of 2012. For the nine month period ended September 30, 2013, the loan loss provision totaled \$3.1 million compared to \$13.4 million for the same period in 2012. The decrease compared to the second quarter of 2013 reflected continued improvement in key credit metrics, including our level of classified loans which declined noticeably during the quarter. The reduction in the provision from both of the prior periods was primarily due to a significant decline in loan losses, a reduced level of problem loan inflow, and overall improvement in key credit metric trends. Net charge-offs for the third quarter of 2013 totaled \$2.8 million, or 0.78% (annualized), of average loans compared to \$2.0 million, or 0.54%, for the second quarter of 2013 and \$2.6 million, or 0.66%, in the third quarter of 2012. For the first nine months of 2013, net charge-offs totaled \$7.2 million, or 0.66% (annualized), of average loans compared to \$14.2 million, or 1.21%, for the same period of 2012. Lower charge-offs in our residential real estate and commercial real estate portfolios drove the decrease in loan losses comparing 2013 to 2012. As compared to 2013, charge-off experience in 2012 reflects the resolution of higher loss exposure construction and land loans. At September 30, 2013, the allowance for loan losses of \$25.0 million was 1.75% of outstanding loans (net of overdrafts) and provided coverage of 60% of nonperforming loans compared to 1.89% and 66%, respectively, at June 30, 2013, and 1.93% and 45%, respectively, at December 31, 2012.

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

(Dollars in Thousands, except per share data)	Three Months Ended			Nine Months Ended	
	Sept 30, 2013	June 30, 2013	Sept 30, 2012	Sept 30, 2013	Sept 30, 2012
<b>CHARGE-OFFS</b>					
Commercial, Financial and Agricultural	\$ 138	\$ 119	\$ 331	\$ 411	\$ 657
Real Estate - Construction	278	110	127	998	402
Real Estate - Commercial Mortgage	882	1,050	512	2,975	5,562
Real Estate - Residential	1,178	1,053	981	2,914	6,843
Real Estate - Home Equity	362	322	834	797	2,152
Consumer	674	351	355	1,321	1,635
Total Charge-offs	3,512	3,005	3,140	9,416	17,251
<b>RECOVERIES</b>					
Commercial, Financial and Agricultural	87	38	53	176	203
Real Estate - Construction	1	—	9	1	36
Real Estate - Commercial Mortgage	167	144	34	349	214
Real Estate - Residential	167	396	76	659	1,208
Real Estate - Home Equity	13	224	15	255	149
Consumer	238	244	382	744	1,228
Total Recoveries	673	1,046	569	2,184	3,038
Net Charge-offs	\$2,839	\$1,959	\$2,571	\$7,232	\$14,213
Net Charge-offs (Annualized) as a percent of Average Loans Outstanding, Net of Unearned Income	0.78 %	0.54 %	0.66 %	0.66 %	1.21 %

### Noninterest Income

Noninterest income for the third quarter of 2013 totaled \$14.3 million, an increase of \$0.5 million, or 3.3%, over the second quarter of 2013 and \$0.7 million, or 5.4%, over the third quarter of 2012. The increase over the second quarter of 2013 was driven by higher deposit fees of \$0.3 million and wealth management fees of \$0.2 million. Compared to the third quarter of 2012, the increase was due to higher wealth management fees driven by an increase in retail brokerage fees. For the nine month period ended September 30, 2013, noninterest income totaled \$41.7 million, a \$0.7 million increase over the same period in 2012 due to higher wealth management fees of \$0.6 million and mortgage banking fees of \$0.2 million.

Noninterest income represented 42.8% of operating revenues (net interest income plus noninterest income) in the third quarter of 2013 compared to 41.7% in the second quarter of 2013 and 39.3% in the third quarter of 2012. For the nine month period ended September 30, 2013, noninterest income represented 41.7% of operating revenues compared to

39.3% for the same period of 2012. The increase in this metric compared to both corresponding periods in 2012 reflected a reduction in net interest income.

The table below reflects the major components of noninterest income.

(Dollars in Thousands)	Three Months Ended			Nine Months Ended	
	Sept 30, 2013	June 30, 2013	Sept 30, 2012	Sept 30, 2013	Sept 30, 2012
Deposit Fees	\$6,474	\$6,217	\$6,406	\$18,856	\$19,028
Bank Card Fees	2,715	2,754	2,616	8,130	8,171
Wealth Management Fees	2,130	1,901	1,686	5,946	5,363
Mortgage Banking Fees	869	968	978	2,880	2,690
Data Processing Fees	662	670	687	1,985	2,042
Other	1,456	1,339	1,202	3,946	3,773
Total Noninterest Income	\$14,306	\$13,849	\$13,575	\$41,743	\$41,067

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

*Deposit Fees.* Deposit fees for the third quarter of 2013 totaled \$6.5 million, an increase of \$257,000, or 4.1%, over the second quarter of 2013 and \$68,000, or 1.1%, from the third quarter of 2012. For the nine month period, deposit fees totaled \$18.9 million, a decrease of \$172,000, or 0.9%, from the comparable period in 2012. The increase over the second quarter of 2013 was attributable to a higher level of overdraft fees and the increase over the third quarter of 2012 reflected a lower level of charged-off checking accounts. Compared to the nine month period of 2012, the decrease reflected a reduction in overdraft fees and a higher level of charged-off checking accounts, partially offset by higher checking account maintenance fees and commercial account analysis fees.

*Bank Card Fees.* Bank card fees totaled \$2.7 million for the third quarter of 2013, a decrease of \$39,000, or 1.4%, from the second quarter of 2013 and an increase of \$99,000, or 3.8%, over the third quarter of 2012. For the nine month period, bank card fees totaled \$8.1 million, which represented a decrease of \$41,000, or 0.5%, from the same period of 2012. The slight decrease from second quarter of 2013 reflected lower card spending. Compared to the third quarter of 2012, higher card spending drove the increase. For the nine month period, the slight decrease reflects a change in transaction mix yielding a lower interchange rate.

*Wealth Management Fees.* Wealth management fees include both trust fees (i.e., managed accounts, trusts/estates, and retirement plans) and retail brokerage fees (i.e., investment and insurance products) and totaled \$2.1 million for the third quarter of 2013, an increase of \$229,000, or 12.0%, over the second quarter of 2013 and \$444,000, or 26.3%, over the third quarter of 2012. For the nine month period, wealth management fees totaled \$5.9 million, an increase of \$583,000, or 10.9%, over the same period of 2012. The increase over the second quarter of 2013 reflects higher retail brokerage fees of \$181,000 and trust fees of \$48,000. Compared to the third quarter of 2012, the increase reflected higher retail brokerage fees of \$488,000 partially offset by lower trust fees of \$89,000. For the nine month period, the increase reflected higher retail brokerage fees of \$741,000 partially offset by lower trust fees of \$158,000. The higher level of retail brokerage fees for all periods was driven by higher trading activity by our clients and new accounts opened. The slight increase in trust fees over the second quarter of 2013 reflected new accounts opened during the quarter. For the comparable periods of 2012, the reduction in trust fees was driven by a decline in assets under management, primarily due to account distributions. At September 30, 2013, total assets under management were approximately \$1.122 billion compared to \$1.124 billion at December 31, 2012 and \$1.118 billion at September 30, 2012.

*Mortgage Banking Fees.* Mortgage banking fees totaled \$0.9 million for the third quarter of 2013, a decrease of \$99,000, or 10.2%, from the second quarter of 2013 and \$109,000, or 11.1%, from the third quarter of 2012. For the nine month period, fees totaled \$2.9 million, an increase of \$190,000, or 7.1%, over the same period of 2012. A lower level of loans funded in the third quarter of 2013 drove the decrease in fees from both the second quarter of 2013 and third quarter of 2012 and reflects a slowdown in refinance activity. The increase for the nine month period was attributable to a higher margin realized for sold loans. The mix of refinance and home purchase new loan production for the first nine months of 2013 was 34% and 66%, respectively, compared to 37% and 63%, respectively, for the same period of 2012.

*Other.* Other income totaled \$1.5 million for the third quarter of 2013, an increase of \$117,000, or 8.7%, over the second quarter of 2013 and \$254,000, or 21.1%, over the third quarter of 2012. The increases over the second quarter of 2013 and third quarter of 2012 were primarily attributable to a higher level of gains from the sale of OREO

properties. For the nine month period, other income totaled \$3.9 million, an increase of \$173,000, or 4.6%, over the same period of 2012 driven by higher bonus income received from our debit card processor reflecting the early 2013 renegotiation of our processing agreement.

### **Noninterest Expense**

Noninterest expense for the third quarter of 2013 totaled \$30.4 million, a decrease of \$0.1 million, or 0.5%, from the second quarter of 2013 attributable to lower compensation expense of \$0.5 million partially offset by higher occupancy expense of \$0.3 million and other expense of \$0.1 million. Compared to the third quarter of 2012, noninterest expense increased by \$0.2 million, or 0.8%, attributable to higher compensation expense of \$0.6 million partially offset by lower occupancy expense of \$0.2 million and other expense of \$0.2 million. For the nine month period ended September 30, 2013, noninterest expense totaled \$92.2 million, a decrease of \$2.9 million, or 3.0%, from the same period of 2012 attributable to lower occupancy expense of \$0.6 million and other expense of \$3.3 million partially offset by higher compensation expense of \$1.1 million.

The table below reflects the major components of noninterest expense.

(Dollars in Thousands)	Three Months Ended			Nine Months Ended	
	Sept 30, 2013	June 30, 2013	Sept 30, 2012	Sept 30, 2013	Sept 30, 2012
Salaries	\$12,139	\$11,999	\$12,102	\$36,483	\$37,139
Associate Benefits	4,020	4,648	3,408	13,061	11,331
Total Compensation	16,158	16,647	15,510	49,544	48,470
Premises	2,298	2,149	2,345	6,712	6,935
Furniture and Equipment	2,105	2,012	2,245	6,270	6,691
Total Occupancy	4,403	4,161	4,590	12,982	13,626
Legal Fees	877	918	1,090	2,796	3,286
Professional Fees	1,146	1,046	1,070	3,329	3,574
Processing Services	1,465	1,307	951	3,898	2,930
Advertising	497	493	420	1,312	1,424
Travel and Entertainment	249	212	220	655	625
Printing and Supplies	255	257	355	762	926
Telephone	466	466	472	1,423	1,407
Postage	355	326	356	995	1,245
Insurance – Other	1,027	1,040	1,022	3,107	3,072
Intangible Amortization	46	48	108	162	323
Other Real Estate	2,148	2,408	2,603	7,440	9,528
Miscellaneous	1,341	1,253	1,434	3,810	4,655
Total Other	9,872	9,774	10,101	29,689	32,995
Total Noninterest Expense	\$30,433	\$30,582	\$30,201	\$92,215	\$95,091

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

*Compensation.* Compensation expense totaled \$16.2 million for the third quarter of 2013, a decrease of \$489,000, or 2.9%, from the second quarter of 2013 and an increase of \$648,000, or 4.2%, over the third quarter of 2012. The decrease compared to the second quarter of 2013 reflects lower associate benefit expense of \$628,000 partially offset by higher salary expense of \$140,000. The decrease in the associate benefit expense category was primarily due to lower pension plan expense and the increase in salary expense category reflected an increase in associate base salaries. The reduction in pension plan expense reflected a lower required 2013 expense upon finalization of actuarial work during the third quarter. Associate base salaries increased due to annual merit raises that were effective late in the second quarter of 2013. Compared to the third quarter of 2012, the increase was driven by a \$612,000 increase in associate benefit expense reflective of higher expense for our pension plan. For the nine month period, compensation expense totaled \$49.5 million, a \$1.1 million, or 2.2%, increase over the same period of 2012 attributable to a \$1.7 million increase in associate benefit expense partially offset by a \$656,000 decline in salary expense. The increase in associate benefit expense was due to higher pension plan expense of \$0.8 million, stock compensation expense of \$0.8 million, and associate insurance expense of \$0.2 million. Utilization of a lower discount rate for the determination of

our pension plan liability drove the increase in pension plan expense while an improved level of financial performance drove the increase in stock compensation expense. The increase in associate insurance expense generally reflected higher health care costs, which overall we continue to control very well. The reduction in salary expense reflected lower headcount primarily due to efficiency gains in our retail banking delivery channel and operational support areas.

*Occupancy.* Occupancy expense (including premises and furniture/equipment) totaled \$4.4 million for the third quarter of 2013, an increase of \$242,000, or 5.8%, over the second quarter of 2013 and a decrease of \$187,000, or 4.1%, from the third quarter of 2012. For the nine month period, occupancy expense totaled \$13.0 million, a \$644,000, or 4.7%, decrease from the same period in 2012. Higher building maintenance and utility costs drove the increase over the second quarter of 2013. Compared to the prior year periods, reductions were realized in most of the premises and furniture/equipment expense categories and were generally driven by stronger cost controls and other cost reduction initiatives.

*Other.* Other noninterest expense totaled \$9.9 million for the third quarter of 2013 compared to \$9.8 million for the second quarter of 2013 and \$10.1 million for the third quarter of 2012. The \$98,000, or 1.0%, increase in other expense over the second quarter of 2013 was primarily due to higher processing fees of \$158,000, professional fees of \$100,000, and miscellaneous expense of \$88,000, partially offset by lower OREO expense of \$260,000. The increase in processing fees reflected the costs of outsourcing our items processing system and was offset by lower salary costs. Professional fees increased primarily due to the payment to a consultant for a profit enhancement initiative. A higher level of debit card losses during the quarter drove the increase in miscellaneous expense. A lower level of property valuation adjustments drove the reduction in OREO expense.



Compared to the third quarter of 2012, the \$229,000, or 2.3%, decline in other expense was primarily due to lower OREO expense of \$455,000, legal fees of \$213,000, and printing/supplies expense of \$100,000, partially offset by higher processing fees of \$514,000. The decline in OREO expense was due to a lower level of property valuation adjustments as well as losses from the sale of properties. Legal fees decreased due to a lower level of support needed for loan collection/resolution activities. Improved cost controls drove the reduction in printing/supplies expense. The increase in processing fees reflected the costs of outsourcing our items processing system in early 2013 and was substantially offset by expense reductions realized in compensation and equipment depreciation.

For the nine month period, other noninterest expense totaled \$29.7 million, a decrease of \$3.3 million, or 10.0%, from the same period of 2012 reflective of lower OREO expense of \$2.1 million, legal fees of \$490,000, professional fees of \$245,000, postage costs of \$250,000, and printing/supplies expense of \$164,000. A lower level of losses from the sale of OREO properties and to a lesser extent a reduction in property carrying costs drove the decline in OREO expense. The decrease in professional fees reflected lower consulting costs as well as audit costs. Postage savings generated from the outsourcing of our client statement processing function as well as overall better control of overnight delivery drove the favorable variance in postage expense. Improved cost controls drove the reduction in printing/supplies expense.

Our operating efficiency ratio (expressed as noninterest expense as a percent of the sum of taxable-equivalent net interest income plus noninterest income) was 90.42% for the third quarter of 2013 compared to 91.07% for the second quarter of 2013 and 86.89% for the third quarter of 2012. For the nine month period, this ratio was 91.39% compared to 90.06% for the comparable period of 2012. The increase in this ratio for the nine-month period reflected a declining level of net interest income contribution to operating revenues that was substantially offset by lower noninterest expense. Reduction in costs related to the management and resolution of nonperforming assets has contributed to the reduction in noninterest expense. We have also made substantial progress over the past two years toward implementing initiatives to reduce core noninterest expense by optimizing our operations, reducing headcount, renegotiating vendor arrangements, and better managing discretionary expenses.

## **Income Taxes**

We realized income tax expense of \$927,000 in the third quarter of 2013 compared to income tax expense of \$569,000 for the second quarter of 2013 and income tax expense \$420,000 for the third quarter of 2012. For the nine month period, we realized income tax expense of \$1.9 million compared to an income tax benefit of \$1.9 million for the same period in 2012. A higher level of book taxable income drove the increase in income tax expense compared to all prior periods. During the second quarter of 2013, income tax expense was unfavorably impacted due to the recognition of a \$95,000 valuation reserve related to an unused state tax credit.

## **FINANCIAL CONDITION**

Average assets totaled approximately \$2.558 billion for the third quarter of 2013, a decrease of \$6.1 million, or 0.2%, from the second quarter of 2013, and an increase of \$24.4 million, or 1.0%, from the fourth quarter of 2012. Average earning assets were \$2.201 billion for the third quarter of 2013, a decrease of \$5.3 million, or 0.2%, from the second quarter of 2013, and an increase of \$22.4 million, or 1.0%, over the fourth quarter of 2012. The change in earning assets from the prior quarter is due to a decline in the overnight funds position reflecting a lower level of public fund deposits. The increase compared to the fourth quarter of 2012 primarily reflected the higher level of deposits resulting from an increase in noninterest bearing demand, money market, and savings accounts.

### **Investment Securities**

In the third quarter of 2013, our average investment portfolio increased \$22.5 million, or 6.8%, from the second quarter of 2013 and increased \$58.6 million, or 19.9%, from the fourth quarter of 2012. As a percentage of average earning assets, the investment portfolio represented 16.0% in the third quarter of 2013, compared to 15.0% in the prior quarter and 13.5% in the fourth quarter of 2012. The increase in the average balance of the investment portfolio compared to the second quarter of 2013 was primarily attributable to increases in all product types, with the exception of mortgage-backed securities. Increases compared to the fourth quarter of 2012 resulted from higher balances of SBA securities, municipal bonds, and US Government agency securities, partially offset by declines in U.S. Treasuries and mortgage-backed securities. When appropriate, we will continue to look to deploy a portion of the overnight funds position in the investment portfolio during the remainder of 2013.

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 and held to maturity. During the third quarter, the collateralized mortgage obligation portfolio totaling \$63.0 million was transferred to the held to maturity classification. Additionally, securities purchased during the third quarter were classified under both the available for sale and held to maturity designations. As of September 30, 2013, \$261.8 million, or 72.9% of the investment portfolio was classified as available for sale, with the remaining \$97.4 million classified as held to maturity.

At September 30, 2013, the available for sale investment portfolio had a net pre-tax unrealized gain of \$0.2 million compared to an unrealized loss of \$0.5 million at June 30, 2013 and an unrealized gain of \$0.9 million at December 31, 2012. The increase in the unrealized gain compared to the prior quarter reflects a favorable pricing shift in the U.S. Treasury yield curve, in conjunction with the transfer of the CMO securities from available for sale to held to maturity. The decrease in unrealized gain as compared to December 31, 2012 is attributable to an unfavorable pricing shift in the U.S. Treasury curve.

At September 30, 2013, there were 112 positions (combined available for sale and held to maturity) with gross pre-tax unrealized losses totaling approximately \$0.4 million. Of the 112 positions, 63 were Ginnie Mae mortgage-backed securities (GNMA), US 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 with the prime rate and are uncapped. Three of these SBA positions have been in an unrealized loss positions for longer than 12 months and have an unrealized loss of \$17,000. The remaining 49 positions were municipal bonds that are pre-refunded, or rated "AA-" or better, with one position being a Federal Farm Credit agency bond. Nine of these positions are municipal bonds which have been in an unrealized loss position for longer than 12 months, and have an unrealized loss of \$1,000. All positions with unrealized losses are not considered impaired, and are expected to mature at par or better. The aforementioned figures do not include an unrealized loss on a preferred stock investment that is currently carried at a zero net book value. This security maintained an unrealized loss of \$0.2 million and \$0.6 million at September 30, 2013 and December 31, 2012, respectively. During the third quarter of 2013, we realized \$0.2 million in additional impairment on this security and have realized \$0.4 million during 2013. We continue to closely monitor the fair value of this security as the issuer continues to experience negative operating trends.

The average maturity of the total investment securities portfolio at September 30, 2013 was 1.82 years compared to 1.73 years and 1.57 years for the June 31, 2013 and December 31, 2012 periods, respectively. The average life of the total portfolio in the third quarter of 2013 extended compared to both prior periods, primarily as U.S. Treasury securities with maturities up to three years were added throughout 2013.

## Loans

Average loans declined (a portion of which is attributable to problem loan resolutions) by \$20.9 million, or 1.4%, from the end of the second quarter of 2013 and \$82.2 million, or 5.4%, from the end of the fourth quarter of 2012. Most loan categories have experienced declines with the reduction primarily in the commercial real estate and residential real estate categories. Our core loan portfolio continues to be impacted by normal, monthly amortization and a higher level of payoffs that have outpaced our new loan production. While new loan production was up quarter over quarter, it continues to be impacted by weak loan demand attributable to the trend toward consumers and businesses deleveraging, the lack of consumer confidence, and a persistently sluggish economy.

New loan production has improved over the past four quarters as our efforts to stimulate new loan growth are ongoing. Without compromising our credit standards or taking on inordinate interest rate risk, we have modified several lending programs in our business and commercial real estate areas to try and mitigate the significant impact

that consumer and business deleveraging is having on our portfolio.

The resolution of problem loans (which has the effect of lowering the loan portfolio as loans are either charged off or transferred to OREO) also contributed to the overall decline. During the third quarter of 2013, loan charge-offs and loans transferred to OREO accounted for \$7.2 million, or 52%, of the net reduction in total loans of \$13.8 million from the second quarter of 2013. For the first nine months of 2013, loan resolution accounted for \$30.4 million, or 34%, of the net reduction in loans of \$89.6 million. The problem loan resolutions and reductions in portfolio balances previously noted are based on “as of” balances, not averages.

**Nonperforming Assets**

Nonperforming assets (nonaccrual loans and OREO) totaled \$94.7 million at the end of the third quarter of 2013, a decrease of \$2.0 million from the second quarter of 2013 and \$22.9 million from the end of the fourth quarter of 2012. Nonaccrual loans totaled \$41.7 million at the end of the third quarter of 2013, a slight increase of \$0.1 million over the second quarter of 2013 and a decrease of \$22.5 million from the fourth quarter of 2012. Nonaccrual loan additions totaled \$11.1 million in the third quarter of 2013 and \$29.6 million for the first nine months of 2013, which compares to \$48.5 million in the first nine months of 2012. The balance of OREO totaled \$53.0 million at the end of the third quarter of 2013, a decrease of \$2.1 million from the end of the second quarter of 2013 and \$0.4 million from the fourth quarter of 2012. During the third quarter of 2013, we added properties totaling \$3.7 million, sold properties totaling \$5.2 million, and recorded valuation adjustments totaling \$0.6 million. During the first nine months of 2013, we added properties totaling \$21.0 million, sold properties totaling \$18.5 million, and recorded valuation adjustments totaling \$2.9 million. Nonperforming assets represented 3.77% of total assets at both September 30, 2013 and June 30, 2013, and 4.47% at December 31, 2012.

(Dollars in Thousands)	September 30, 2013	June 30, 2013	December 31, 2012
Nonaccruing Loans:			
Commercial, Financial and Agricultural	\$ 489	\$ 537	\$ 1,069
Real Estate - Construction	640	1,020	4,071
Real Estate - Commercial Mortgage	25,714	25,957	41,045
Real Estate - Residential	9,530	8,549	13,429
Real Estate - Home Equity	4,741	4,817	4,034
Consumer	569	686	574
Total Nonperforming Loans ("NPLs" <sup>(1)</sup> )	\$ 41,682	\$ 41,566	\$ 64,222
Other Real Estate Owned	53,018	55,087	53,426
Total Nonperforming Assets ("NPAs")	\$ 94,700	\$ 96,653	\$ 117,648
Past Due Loans 30 – 89 Days	\$ 8,427	\$ 8,764	\$ 9,934
Past Due Loans 90 Days or More (accruing)	—	253	—
Performing Troubled Debt Restructurings	50,692	52,729	47,474
Nonperforming Loans/Loans	2.91	% 2.88	% 4.22
Nonperforming Assets/Total Assets	3.77	3.77	4.47
Nonperforming Assets/Loans Plus OREO	6.38	6.44	7.47
Allowance/Nonperforming Loans	60.00	% 65.66	% 45.42

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

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

(Dollars in Thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
NPA Beginning Balance:	\$96,653	\$132,829	\$117,648	\$137,623
Change in Nonaccrual Loans:				
Beginning Balance	41,566	74,770	64,222	75,023
Additions	11,046	15,578	29,527	48,532
Charge-Offs	(3,230 )	(2,871 )	(8,902 )	(14,852 )
Transferred to OREO	(3,342 )	(2,830 )	(19,906 )	(11,578 )
Paid Off/Payments	(2,807 )	(5,806 )	(9,782 )	(11,734 )
Restored to Accrual	(1,551 )	(4,766 )	(13,477 )	(11,316 )
Ending Balance	41,682	74,075	41,682	74,075
Change in OREO:				
Beginning Balance	55,087	58,059	53,426	62,600
Additions	3,697	2,830	21,031	14,039
Valuation Write-downs	(604 )	(714 )	(2,809 )	(2,954 )
Sales	(5,162 )	(7,002 )	(18,531 )	(20,082 )
Other	—	(1 )	(99 )	(431 )
Ending Balance	53,018	53,172	53,018	53,172
NPA Net Change	(1,953 )	(5,582 )	(22,948 )	(10,376 )
NPA Ending Balance	\$94,700	\$127,247	\$94,700	\$127,247

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

(Dollars in Thousands)	Three Months		Nine Months	
	Ended September		Ended September	
	30,	30,	30,	30,
	2013	2012	2013	2012
TDR Beginning Balance:	\$57,902	\$52,304	\$57,353	\$50,651
Additions	4,977	9,798	12,116	22,618
Charge-Offs	(50 )	(157 )	(50 )	(2,036 )
Paid Off/Payments	(746 )	(325 )	(2,639 )	(2,410 )
Removal Due to Change in TDR Status	(511 )	—	(1,632 )	(2,284 )
Defaults	(2,232 )	(2,460 )	(5,808 )	(7,379 )
TDR Ending Balance	\$59,340	\$59,160	\$59,340	\$59,160

#### 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 \$25.0 million at September 30, 2013 compared to \$27.3 million at June 30, 2013 and \$29.2 million at December 31, 2012. The allowance for loan losses was 1.75% of outstanding loans and provided coverage of 60% of nonperforming loans at September 30, 2013 compared to 1.89% and 66%, respectively, at June 30, 2013, and 1.93% and 45%, respectively, at December 31, 2012. The decrease in the allowance from both prior periods reflected a reduction in the impaired and general reserve levels. The reduction in impaired loan reserves reflects the migration of loans to OREO and related charge-offs which outpaced reserve additions for newly impaired loans. The reduction in general reserves was primarily driven by continued improving trends in loan delinquencies and classified loans, as well as lower loss content attributable to improving trends in loan charge-offs. It is management's opinion that the allowance at September 30, 2013 is adequate to absorb losses inherent in the loan portfolio at quarter-end.

## Deposits

Average total deposits were \$2.059 billion for the third quarter of 2013, a decrease of \$8.1 million, or 0.4%, from the second quarter of 2013 and higher by \$8.4 million, or 0.4%, from the fourth quarter of 2012. The decrease in deposits when compared to the second quarter of 2013 resulted primarily from the reduction in the level of public funds and money market accounts offset by higher noninterest bearing demand and savings accounts. When compared to the fourth quarter of 2012, the increase was a result of higher public funds and savings accounts, partially offset by lower certificates of deposit and regular NOW accounts.

Core deposits experienced growth when compared to both periods as the Bank continues to expand relationships and grow the client base. The seasonal inflow of public funds will begin late in the fourth quarter and continue into the first quarter of 2014. Both events are anticipated to increase the overnight funds position during the fourth quarter of 2013.

Our mix of deposits continues to change as higher rate certificates of deposit are replaced with lower rate non-maturity deposits and noninterest bearing demand accounts. Prudent pricing discipline will continue to be the key to managing our mix of deposits. Therefore, we do not attempt to compete with higher rate paying competitors for 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 three 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, and 300 basis points ("bp"), although we may elect not to use particular scenarios that we determine are impractical in the 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	+300 bp	+200 bp	+100 bp	-100 bp
Policy Limit (±)	10.0%	7.5%	5.0%	5.0%
September 30, 2013	0.9%	2.6%	2.5%	-1.8%
June 30, 2013	1.9%	3.1%	2.7%	-1.3%

The Net Interest Income at Risk position was slightly less favorable at the end of the third quarter of 2013, when compared to the prior quarter-end, for all rate scenarios. The unfavorable change from the prior quarter end in all scenarios reflects lower levels of repricing assets, primarily overnight funds, partially offset by lower interest bearing deposit balances, primarily in public funds and money market accounts. All measures of net interest income at risk are within our prescribed policy limits.

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	+300 bp	+200 bp	+100 bp	-100 bp
Policy Limit (±)	12.5%	10.0%	7.5%	7.5%
September 30, 2013	0.8%	4.1%	4.4%	-5.5%
June 30, 2013	2.4%	5.3%	5.0%	-4.9%

As of September 30, 2013, the improvement in the economic value of equity in all rate scenarios versus the base case was less favorable than it was as of June 30, 2013. This unfavorable variance is primarily attributable to the overall

change in market interest rates during the third quarter of 2013. In both cases, in the up 300 bp scenario (relative to the up 200 and 100 bp scenarios), the level of improvement in the economic value of equity declined. This is attributable to the varied assumptions on the non-maturity deposits. Based on historical data, interest rates on non-maturity deposits were increased in escalating increments in the rising rate scenarios, with the up 300 bp scenario being the most aggressive. All measures of economic value of equity were within our prescribed policy limits.

*(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 September 30, 2013, we had the ability to generate \$762.2 million in additional liquidity through all of our available resources. 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. 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 to 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 1.82 years and as of quarter-end had a net unrealized pre-tax gain of \$0.2 million.

Our average net overnight funds position (defined as funds sold plus interest bearing deposits with other banks less funds purchased) was \$412.1 million during the third quarter of 2013 compared to an average net overnight funds sold position of \$419.0 million in the second quarter of 2013 and an average overnight funds sold position of \$366.0 million in the fourth quarter of 2012. The lower balance when compared to the second quarter of 2013 primarily reflects the decline in deposits. Additionally, a shift in earning asset mix continued to occur due to growth in the investment portfolio while the loan portfolio declined. The increase when compared to the fourth quarter of 2012 reflected the declining loan portfolio and a higher level of public funds, partially offset by an increase in the investment portfolio.

We expect to make capital expenditures of approximately \$3.0 million over the next 12 months, which will consist primarily of office remodeling, office equipment/furniture purchases and technology purchases. We believe that these capital expenditures will be funded with existing resources without impairing our ability to meet our on-going obligations.

## **Borrowings**

At September 30, 2013, advances from the FHLB consisted of \$44.4 million in outstanding debt consisting of 41 notes. During the first nine months of 2013, the Bank made FHLB advance payments totaling approximately \$2.7 million, paid off nine advances totaling approximately \$7.8 million and obtained one new FHLB advance totaling \$1.3 million. 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 will adjust 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 trust preferred securities 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. As of February 2012, in consultation with the Federal Reserve, we elected to defer the interest payments on the notes. We will, however, continue the accrual of the interest on the notes in accordance with our contractual obligations.

## Capital

Equity capital was \$251.2 million as of September 30, 2013, compared to \$249.3 million as of June 30, 2013 and \$246.9 million at December 31, 2012. Our leverage ratio was 10.16%, 10.07%, and 9.60%, respectively, and our tangible capital ratio was 6.84%, 6.64%, and 6.35%, respectively, for the same periods. Our risk-adjusted capital ratio of 16.97% at September 30, 2013, exceeds the 10% threshold to be designated as “well-capitalized” under the risk-based regulatory guidelines.

For the first nine months of 2013, shareowners’ equity increased \$4.3 million, or 2.3%, on an annualized basis. During this same period, shareowners’ equity was positively impacted by net income of \$3.3 million, stock compensation accretion of \$0.9 million, and the issuance of stock totaling \$0.9 million. Shareowners’ equity was negatively impacted by a \$0.8 million decline in the unrealized gain on investment securities.

At September 30, 2013, our common stock had a book value of \$14.44 per diluted share compared to \$14.36 at June 30, 2013 and \$14.31 per diluted share at December 31, 2012. 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 September 30, 2013, the net unrealized loss on investment securities available for sale was \$0.2 million and the amount of our unfunded pension liability was \$30.1 million.

State and federal regulations place certain restrictions on the payment of dividends by both CCBG and the Bank. Florida law and Federal regulations limit the amount of dividends that the Bank can pay annually to us. Pursuant to the Federal Reserve Resolutions (discussed in further detail within our 2012 Form 10-K), without prior approval, CCBG is prohibited from paying dividends to shareowners and CCB is prohibited from paying dividends to CCBG. In December 2011, we suspended quarterly dividend payments to our shareowners.

## **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 September 30, 2013, we had \$283.8 million in commitments to extend credit and \$11.3 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 its ability to meet 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 2012 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 require 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 other intangible assets, 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 2012 Form 10-K.

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

	Three Months Ended September 30, 2013			2012			Nine Months Ended September 30, 2013			2012		
	Average			Average	Average		Average	Average	Average	Average		
(Dollars in Thousands)	Balances	Interest	Rate	Balances	Interest	Rate	Balances	Interest	Rate	Balances	Interest	Rate
<b>Assets:</b>												
Loans <sup>(1)(2)</sup>	\$1,436,039	\$19,342	5.34%	\$1,541,262	\$21,366	5.51%	\$1,462,904	\$59,361	5.43%	\$1,569,4		
Taxable Securities <sup>(2)</sup>	232,094	571	0.95	214,431	691	1.28	224,379	1,739	0.99	224,584		
Tax-Exempt Securities	121,119	223	0.73	67,446	163	0.97	102,496	596	0.77	62,509		
Funds Sold	412,138	269	0.26	386,027	254	0.26	426,401	818	0.26	390,122		
Total Earning Assets	2,201,390	20,405	3.68%	2,209,166	22,474	4.05%	2,216,180	62,514	3.77%	2,246,6		
Cash & Due From Banks	51,640			47,207			50,470			48,112		
Allowance For Loan Losses	(27,636 )			(30,260 )			(29,028 )			(31,077		
Other Assets	333,001			340,126			336,098			345,361		
<b>TOTAL ASSETS</b>	<b>\$2,558,395</b>			<b>\$2,566,239</b>			<b>\$2,573,720</b>			<b>\$2,609,0</b>		
<b>Liabilities:</b>												
NOW Accounts	\$676,855	\$107	0.06%	\$740,178	\$144	0.08%	\$726,915	\$388	0.07%	\$790,733		
Money Market Accounts	284,920	53	0.07	287,250	60	0.08	285,809	161	0.08	281,746		
Savings Accounts	207,631	26	0.05	179,445	23	0.05	201,203	74	0.05	173,346		
Other Time Deposits	231,490	149	0.26	263,007	253	0.38	233,663	494	0.28	273,839		
Total Interest Bearing Deposits	1,400,896	335	0.09	1,469,880	480	0.13	1,447,590	1,117	0.10	1,519,6		
Short-Term Borrowings	49,919	46	0.37	59,184	71	0.48	52,505	189	0.48	54,289		
Subordinated Note Payable	62,887	339	2.11	62,887	372	2.31	62,887	1,020	2.14	62,887		
Other Long-Term Borrowings	40,832	330	3.21	38,494	372	3.85	41,550	1,010	3.25	41,123		
Total Interest Bearing Liabilities	1,554,534	1,050	0.27%	1,630,445	1,295	0.32%	1,604,532	3,336	0.28%	1,677,9		
Noninterest Bearing Deposits	658,602			605,602			628,955			604,333		
Other Liabilities	93,642			78,446			89,673			73,795		
<b>TOTAL LIABILITIES</b>	<b>2,306,778</b>			<b>2,314,493</b>			<b>2,323,160</b>			<b>2,356,0</b>		



TOTAL SHAREOWNERS' EQUITY	251,617	251,746	250,560	252,941
TOTAL LIABILITIES AND SHAREOWNERS' EQUITY	\$2,558,395	\$2,566,239	\$2,573,720	\$2,609,000
Interest Rate Spread		3.41%	3.73%	3.49%
Net Interest Income	\$19,355	\$21,179	\$59,178	
Net Interest Margin <sup>(3)</sup>		3.49%	3.82%	3.57%

*Average balances include nonaccrual loans. Interest income periods in this table include loan fees of \$396,000 and (1)\$1.2 million for the three and nine months ended September 30, 2013 and \$378,000 and \$1.2 million for the comparable periods ended September 30, 2012.*

(2) *Interest income includes the effects of taxable equivalent adjustments using a 35% tax rate.*

(3) *Taxable equivalent net interest income divided by average earning 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, 2012.

### **Item 4. CONTROLS AND PROCEDURES**

#### **Evaluation of Disclosure Controls and Procedures**

As of September 30, 2013, 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 September 30, 2013, 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 2012 Form 10-K, as updated in our subsequent quarterly reports. The risks described in our 2012 Form 10-K, as updated, 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**

None.

**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.

101.INS XBRL Instance Document

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: November 8, 2013

Exhibit Index

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