

Section 1: 10-Q (FORM 10-Q)

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

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2018

OR

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

For the transition period from _____ to _____

Commission File Number: 0-13358



(Exact name of registrant as specified in its charter)

Florida

(State or other jurisdiction of incorporation or organization)

217 North Monroe Street, Tallahassee, Florida

(Address of principal executive office)

59-2273542

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

32301

(Zip Code)

(850) 402-7821

(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, a smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer", "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

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

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards pursuant to Section 13(a) of The Exchange Act.

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, 2018, 17,058,521 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, 2018
TABLE OF CONTENTS

	Page
PART I – Financial Information	
Item 1. Consolidated Financial Statements (Unaudited)	
Consolidated Statements of Financial Condition – September 30, 2018 and December 31, 2017	4
Consolidated Statements of Income – Three and Nine Months Ended September 30, 2018 and 2017	5
Consolidated Statements of Comprehensive Income – Three and Nine Months Ended September 30, 2018 and 2017	6
Consolidated Statements of Changes in Shareowners' Equity – Nine Months Ended September 30, 2018 and 2017	7
Consolidated Statements of Cash Flows – Nine Months Ended September 30, 2018 and 2017	8
Notes to Consolidated Financial Statements	9
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	30
Item 3. Quantitative and Qualitative Disclosure About Market Risk	48
Item 4. Controls and Procedures	48
PART II – Other Information	
Item 1. Legal Proceedings	48
Item 1A. Risk Factors	48
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	48
Item 3. Defaults Upon Senior Securities	48
Item 4. Mine Safety Disclosure	48
Item 5. Other Information	48
Item 6. Exhibits	49
Signatures	50

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 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.

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, 2017 (the “2017 Form 10-K”): (a) “Introductory Note” in Part I, Item 1. “Business”; (b) “Risk Factors” in Part I, Item 1A, as updated in our subsequent quarterly reports filed on Form 10-Q; and (c) “Introduction” in “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” in Part II, Item 7, as well as:

- our ability to successfully manage interest rate risk, liquidity risk, and other risks inherent to our industry;
- legislative or regulatory changes, the ability to repay and qualified mortgage standards;
- the effects of security breaches and computer viruses that may affect our computer systems or fraud related to debit card products;
- the accuracy of our financial statement estimates and assumptions, including the estimates used for our loan loss provision, deferred tax asset valuation and pension plan;
- the frequency and magnitude of foreclosure of our loans;
- the effects of our lack of a diversified loan portfolio, including the risks of geographic and industry concentrations;
- the strength of the United States economy in general and the strength of the local economies in which we conduct operations;
- our ability to declare and pay dividends, the payment of which is now subject to our compliance with heightened capital requirements;
- changes in the securities and real estate markets;
- changes in monetary and fiscal policies of the U.S. Government;
- inflation, interest rate, market and monetary fluctuations;
- the effects of harsh weather conditions, including hurricanes, and man-made disasters;
- our ability to comply with the extensive laws and regulations to which we are subject, including the laws for each jurisdiction where we operate;
- the willingness of clients to accept third-party products and services rather than our products and services and vice versa;
- increased competition and its effect on pricing;
- technological changes;
- negative publicity and the impact on our reputation;
- changes in consumer spending and saving habits;
- growth and profitability of our noninterest income;
- changes in accounting principles, policies, practices or guidelines;
- the limited trading activity of our common stock;
- the concentration of ownership of our common stock;
- anti-takeover provisions under federal and state law as well as our Articles of Incorporation and our Bylaws;
- other risks described from time to time in our filings with the Securities and Exchange Commission; and
- our ability to manage the risks involved in the foregoing.

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

PART I. FINANCIAL INFORMATION

Item 1.

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

<i>(Dollars in Thousands)</i>	(Unaudited) September 30, 2018	December 31, 2017
ASSETS		
Cash and Due From Banks	\$ 48,423	\$ 58,419
Federal Funds Sold and Interest Bearing Deposits	26,839	227,023
Total Cash and Cash Equivalents	75,262	285,442
Investment Securities, Available for Sale, at fair value	484,243	480,911
Investment Securities, Held to Maturity, at amortized cost (fair value of \$223,531 and \$215,007)	227,923	216,679
Total Investment Securities	712,166	697,590
Loans Held For Sale	8,297	4,817
Loans, Net of Unearned Income	1,773,754	1,653,492
Allowance for Loan Losses	(14,219)	(13,307)
Loans, Net	1,759,535	1,640,185
Premises and Equipment, net	89,567	91,698
Goodwill	84,811	84,811
Other Real Estate Owned	2,720	3,941
Other Assets	86,832	90,310
Total Assets	<u>\$ 2,819,190</u>	<u>\$ 2,898,794</u>
LIABILITIES		
Deposits:		
Noninterest Bearing Deposits	\$ 934,146	\$ 874,583
Interest Bearing Deposits	1,447,070	1,595,294
Total Deposits	2,381,216	2,469,877
Short-Term Borrowings	16,644	7,480
Subordinated Notes Payable	52,887	52,887
Other Long-Term Borrowings	12,456	13,967
Other Liabilities	57,971	70,373
Total Liabilities	2,521,174	2,614,584
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; 17,058,521 and 16,988,951 shares issued and outstanding at September 30, 2018 and December 31, 2017, respectively	171	170
Additional Paid-In Capital	38,325	36,674
Retained Earnings	293,254	279,410
Accumulated Other Comprehensive Loss, net of tax	(33,734)	(32,044)
Total Shareowners' Equity	298,016	284,210
Total Liabilities and Shareowners' Equity	<u>\$ 2,819,190</u>	<u>\$ 2,898,794</u>

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

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

<i>(Dollars in Thousands, Except Per Share Data)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
INTEREST INCOME				
Loans, including Fees	\$ 21,618	\$ 19,479	\$ 61,686	\$ 56,204
Investment Securities:				
Taxable	3,290	2,150	8,757	5,832
Tax Exempt	182	266	633	795
Federal Funds Sold and Interest Bearing Deposits	302	446	1,949	1,472
Total Interest Income	25,392	22,341	73,025	64,303
INTEREST EXPENSE				
Deposits	1,068	530	2,931	1,199
Short-Term Borrowings	41	15	57	77
Subordinated Notes Payable	568	420	1,595	1,203
Other Long-Term Borrowings	92	115	286	331
Total Interest Expense	1,769	1,080	4,869	2,810
NET INTEREST INCOME	23,623	21,261	68,156	61,493
Provision for Loan Losses	904	490	2,464	1,389
Net Interest Income After Provision For Loan Losses	22,719	20,771	65,692	60,104
NONINTEREST INCOME				
Deposit Fees	5,207	5,153	14,921	15,295
Bank Card Fees	2,828	2,688	8,548	8,361
Wealth Management Fees	2,181	2,197	6,391	6,112
Mortgage Banking Fees	1,343	1,480	3,606	4,344
Other	1,749	1,478	4,861	4,737
Total Noninterest Income	13,308	12,996	38,327	38,849
NONINTEREST EXPENSE				
Compensation	15,891	15,711	47,599	47,211
Occupancy, net	4,645	4,501	13,699	13,437
Other Real Estate Owned, net	347	(118)	1,221	780
Other	7,816	6,613	22,479	21,122
Total Noninterest Expense	28,699	26,707	84,998	82,550
INCOME BEFORE INCOME TAXES	7,328	7,060	19,021	16,403
Income Tax Expense	1,338	2,505	1,255	5,543
NET INCOME	\$ 5,990	\$ 4,555	\$ 17,766	\$ 10,860
BASIC NET INCOME PER SHARE	\$ 0.35	\$ 0.27	\$ 1.04	\$ 0.64
DILUTED NET INCOME PER SHARE	\$ 0.35	\$ 0.27	\$ 1.04	\$ 0.64
Average Common Basic Shares Outstanding	17,056	16,965	17,043	16,946
Average Common Diluted Shares Outstanding	17,125	17,044	17,102	17,009

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)

<i>(Dollars in Thousands)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
NET INCOME	\$ 5,990	\$ 4,555	\$ 17,766	\$ 10,860
Other comprehensive income, before tax:				
Change in net unrealized gain/loss on securities available for sale	(553)	(99)	(2,306)	516
Amortization of unrealized losses on securities transferred from available for sale to held to maturity	13	19	42	57
Total Investment Securities	(540)	(80)	(2,264)	573
Other comprehensive (loss) income, before tax	(540)	(80)	(2,264)	573
Deferred tax (benefit) expense related to other comprehensive income	(137)	(31)	(574)	222
Other comprehensive (loss) income, net of tax	(403)	(49)	(1,690)	351
TOTAL COMPREHENSIVE INCOME	\$ 5,587	\$ 4,506	\$ 16,076	\$ 11,211

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

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

	Shares	Common	Additional	Retained	Accumulated Other Comprehensive Loss, Net of	Total
<i>(Dollars In Thousands, Except Share Data)</i>	Outstanding	Stock	Paid-In Capital	Earnings	Taxes	
Balance, January 1, 2017	16,844,698	\$ 168	\$ 34,188	\$ 267,037	\$ (26,225)	\$ 275,168
Net Income	-	-	-	10,860	-	10,860
Other Comprehensive Income, net of tax	-	-	-	-	351	351
Cash Dividends (\$0.1700 per share)	-	-	-	(2,884)	-	(2,884)
Stock Based Compensation	-	-	1,196	-	-	1,196
Impact of Transactions Under Compensation Plans, net	121,349	2	508	-	-	510
Balance, September 30, 2017	<u>16,966,047</u>	<u>\$ 170</u>	<u>\$ 35,892</u>	<u>\$ 275,013</u>	<u>\$ (25,874)</u>	<u>\$ 285,201</u>
Balance, January 1, 2018	16,988,951	\$ 170	\$ 36,674	\$ 279,410	\$ (32,044)	\$ 284,210
Net Income	-	-	-	17,766	-	17,766
Other Comprehensive Loss, net of tax	-	-	-	-	(1,690)	(1,690)
Cash Dividends (\$0.2300 per share)	-	-	-	(3,922)	-	(3,922)
Stock Based Compensation	-	-	978	-	-	978
Impact of Transactions Under Compensation Plans, net	69,570	1	673	-	-	674
Balance, September 30, 2018	<u>17,058,521</u>	<u>\$ 171</u>	<u>\$ 38,325</u>	<u>\$ 293,254</u>	<u>\$ (33,734)</u>	<u>\$ 298,016</u>

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

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

<i>(Dollars in Thousands)</i>	Nine Months Ended September 30,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	\$ 17,766	\$ 10,860
Adjustments to Reconcile Net Income to		
Cash Provided by Operating Activities:		
Provision for Loan Losses	2,464	1,389
Depreciation	4,845	4,966
Amortization of Premiums, Discounts, and Fees, net	5,253	4,928
Net (Increase) Decrease in Loans Held-for-Sale	(3,480)	3,086
Stock Compensation	978	1,196
Net Tax Benefit From Stock-Based Compensation	(41)	(223)
Deferred Income Taxes	1,847	247
Net Loss on Sales and Write-Downs of Other Real Estate Owned	941	456
Loss on Disposal of Premises and Equipment	57	276
Net Decrease in Other Assets	3,040	2,559
Net (Decrease) Increase in Other Liabilities	(12,208)	6,487
Net Cash Provided By Operating Activities	21,462	36,227
CASH FLOWS FROM INVESTING ACTIVITIES		
Securities Held to Maturity:		
Purchases	(102,428)	(60,703)
Payments, Maturities, and Calls	89,932	53,031
Securities Available for Sale:		
Purchases	(129,502)	(122,949)
Payments, Maturities, and Calls	119,092	130,997
Purchases of Loans Held for Investment	(25,048)	(44,083)
Net Increase in Loans	(98,007)	(27,327)
Proceeds From Sales of Other Real Estate Owned	1,540	5,952
Purchases of Premises and Equipment	(2,771)	(3,052)
Net Cash Used In Investing Activities	(147,192)	(68,134)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net Decrease in Deposits	(88,661)	(64,669)
Net Increase (Decrease) in Short-Term Borrowings	9,164	(3,020)
Repayment of Other Long-Term Borrowings	(1,511)	(2,786)
Dividends Paid	(3,922)	(2,884)
Issuance of Common Stock Under Compensation Plans	480	333
Net Cash Used In Financing Activities	(84,450)	(73,026)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(210,180)	(104,933)
Cash and Cash Equivalents at Beginning of Period	285,442	296,047
Cash and Cash Equivalents at End of Period	\$ 75,262	\$ 191,114
Supplemental Cash Flow Disclosures:		
Interest Paid	\$ 4,837	\$ 2,825
Income Taxes Paid	\$ 151	\$ 4,044
Noncash Investing and Financing Activities:		
Loans Transferred to Other Real Estate Owned	\$ 1,260	\$ 2,024

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

CAPITAL CITY BANK GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

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

Basis of Presentation. The consolidated financial statements in this Quarterly Report on Form 10-Q include the accounts of CCBG and its wholly-owned subsidiary, Capital City Bank (“CCB” or the “Bank”). All material inter-company transactions and accounts have been eliminated. Certain previously reported amounts have been reclassified to conform to the current year’s presentation.

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

The consolidated statement of financial condition at December 31, 2017 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, 2017.

Income Taxes. For the first nine months of 2018, the Company realized income tax expense of \$1.3 million, which reflected three discrete tax benefit items totaling \$3.3 million resulting from the effect of federal tax reform, enacted in December 2017, specifically related to pension plan contributions made in 2018 for the plan year 2017. The discrete tax items for 2018 totaled \$1.5 million for the first quarter, \$1.4 million for the second quarter and \$0.4 million for the third quarter. Absent these discrete items, the Company’s effective tax rate was approximately 24%.

Accounting Changes

Revenue Recognition. Accounting Standards Codification (“ASC”) 606, Revenue from Contracts with Customers (“ASC 606”), establishes principles for reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity’s contracts to provide goods or services to customers. The core principle requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration that it expects to be entitled to receive in exchange for those goods or services recognized as performance obligations are satisfied.

The majority of the Company’s revenue-generating transactions are not subject to ASC 606, including revenue generated from financial instruments, such as our loans, letters of credit, and investment securities, and revenue related to the sale of residential mortgages in the secondary market, as these activities are subject to other GAAP discussed elsewhere within our disclosures. Descriptions of the major revenue-generating activities that are within the scope of ASC 606, which are presented in the accompanying statements of income as components of non-interest income are as follows:

Deposit Fees - these represent general service fees for monthly account maintenance and activity- or transaction-based fees and consist of transaction-based revenue, time-based revenue (service period), item-based revenue or some other individual attribute-based revenue. Revenue is recognized when the Company’s performance obligation is completed which is generally monthly for account maintenance services or when a transaction has been completed. Payment for such performance obligations are generally received at the time the performance obligations are satisfied.

Wealth Management - trust fees and retail brokerage fees – trust fees represent monthly fees due from wealth management clients as consideration for managing the client’s assets. Trust services include custody of assets, investment management, fees for trust services and similar fiduciary activities. Revenue is recognized when the Company’s performance obligation is completed each month or quarter, which is the time that payment is received. Also, retail brokerage fees are received from a third party broker-dealer, for which the Company acts as an agent, as part of a revenue-sharing agreement for fees earned from customers that are referred to the third party. These fees are for transactional and advisory services and are paid by the third party on a monthly basis and recognized ratably throughout the quarter as the Company’s performance obligation is satisfied.

Bank Card Fees – bank card related fees primarily includes interchange income from client use of consumer and business debit cards. Interchange income is a fee paid by a merchant bank to the card-issuing bank through the interchange network. Interchange fees are set by the credit card associations and are based on cardholder purchase volumes. The Company records interchange income as transactions occur.

Gains and Losses from the Sale of Bank Owned Property – the performance obligation in the sale of other real estate owned typically will be the delivery of control over the property to the buyer. If the Company is not providing the financing of the sale, the transaction price is typically identified in the purchase and sale agreement. However, if the Company provides seller financing, the Company must determine a transaction price, depending on if the sale contract is at market terms and taking into account the credit risk inherent in the arrangement.

Other non-interest income primarily includes items such as mortgage banking fees (gains from the sale of residential mortgage loans held for sale), bank-owned life insurance, and safe deposit box fees none of which are subject to the requirements of ASC 606.

The Company has made no significant judgments in applying the revenue guidance prescribed in ASC 606 that affects the determination of the amount and timing of revenue from the above-described contracts with clients.

The Company has applied ASC 606 using the modified retrospective approach effective on January 1, 2018 to all existing contracts with clients covered under the scope of the standard. The Company did not have an aggregate effect of modification resulting from adoption of ASC 606, and no financial statement line items were affected by this change in accounting standard.

Equity Securities. Beginning January 1, 2018, upon adoption of ASU 2016-01, equity securities with readily determinable fair values are stated at fair value with realized and unrealized gains and losses reported in income. For periods prior to January 1, 2018, equity securities were classified as available-for-sale and stated at fair value with unrealized gains and losses reported as a separate component of AOCI, net of tax. Equity securities without readily determinable fair values are recorded at cost less any impairment, if any. Upon adoption, the Company reclassified one security in the amount of \$0.8 million to other assets in accordance with this accounting standard.

Employee Benefit Plans. Accounting Standards Update (“ASU”) 2017-07, Compensation – Retirement Benefits (Topic 715) requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item or items are used to present the other components of net benefit cost, that line item or items must be appropriately described. If a separate line item or items are not used, the line item or items used in the income statement to present the other components of net benefit cost must be disclosed. In accordance with this accounting standard, the Company reclassified the non-service cost components of its net periodic benefit cost to other noninterest expense in the accompanying statements of income (See Note 5 – Employee Benefit Plans). Prior year amounts were retrospectively adjusted in accordance with the accounting standard. The effects on the statements of income were as follows:

<u>(Dollars in Thousands)</u>	<u>Period Presented</u>	<u>Line Item</u>	
		<u>Compensation</u>	<u>Other Expense</u>
	Three Months Ended September 30, 2018	(\$457)	\$457
	Three Months Ended September 30, 2017	(\$638)	\$638
	Nine Months Ended September 30, 2018	(\$1,371)	\$1,371
	Nine Months Ended September 30, 2017	(\$1,926)	\$1,926

NOTE 2 – INVESTMENT SECURITIES

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

	September 30, 2018				December 31, 2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Market Value	Amortized Cost	Unrealized Gain	Unrealized Losses	Market Value
Available for Sale								
U.S. Government Treasury	\$ 272,335	\$ -	\$ 4,222	\$ 268,113	\$ 237,505	\$ -	\$ 2,164	\$ 235,341
U.S. Government Agency	153,087	625	621	153,091	144,324	727	407	144,644
States and Political Subdivisions	54,115	-	276	53,839	91,533	2	378	91,157
Mortgage-Backed Securities	922	50	-	972	1,102	83	-	1,185
Equity Securities ⁽¹⁾	8,228	-	-	8,228	8,584	-	-	8,584
Total	<u>\$ 488,687</u>	<u>\$ 675</u>	<u>\$ 5,119</u>	<u>\$ 484,243</u>	<u>\$ 483,048</u>	<u>\$ 812</u>	<u>\$ 2,949</u>	<u>\$ 480,911</u>
Held to Maturity								
U.S. Government Treasury	\$ 35,103	\$ -	\$ 702	\$ 34,401	\$ 98,256	\$ -	\$ 441	\$ 97,815
States and Political Subdivisions	6,566	-	45	6,521	6,996	-	41	6,955
Mortgage-Backed Securities	186,254	207	3,852	182,609	111,427	22	1,212	110,237
Total	<u>\$ 227,923</u>	<u>\$ 207</u>	<u>\$ 4,599</u>	<u>\$ 223,531</u>	<u>\$ 216,679</u>	<u>\$ 22</u>	<u>\$ 1,694</u>	<u>\$ 215,007</u>
Total Investment Securities	<u>\$ 716,610</u>	<u>\$ 882</u>	<u>\$ 9,718</u>	<u>\$ 707,774</u>	<u>\$ 699,727</u>	<u>\$ 834</u>	<u>\$ 4,643</u>	<u>\$ 695,918</u>

⁽¹⁾ Includes Federal Home Loan Bank and Federal Reserve Bank stock, recorded at cost of \$3.4 million, \$4.8 million, respectively, at September 30, 2018 and includes Federal Home Loan Bank, Federal Reserve Bank and FNBB Inc. stock recorded at cost of \$3.1 million, \$4.8 million, and \$0.8 million, respectively, at December 31, 2017. The FNBB, Inc. equity investment was reclassified to other assets at March 31, 2018 in accordance with ASU 2016-01, which was adopted prospectively as allowed by the standard.

Securities with an amortized cost of \$234.5 million and \$328.1 million at September 30, 2018 and December 31, 2017, respectively, were pledged to secure public deposits and for other purposes.

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

As a member of the Federal Reserve Bank of Atlanta, the Bank is required to maintain stock in the Federal Reserve Bank of Atlanta based on a specified ratio relative to the Bank’s capital. Federal Reserve Bank stock is carried at cost.

Maturity Distribution. At September 30, 2018, the Company’s investment securities had the following maturity distribution based on contractual maturity. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations. Mortgage-backed securities and certain amortizing U.S. government agency securities are shown separately because they are not due at a certain maturity date.

<i>(Dollars in Thousands)</i>	Available for Sale		Held to Maturity	
	Amortized Cost	Market Value	Amortized Cost	Market Value
Due in one year or less	\$ 120,134	\$ 119,269	\$ 13,099	\$ 12,963
Due after one year through five years	232,224	228,353	28,570	27,959
Mortgage-Backed Securities	922	972	186,254	182,609
U.S. Government Agency	127,179	127,421	-	-
Equity Securities	8,228	8,228	-	-
Total	<u>\$ 488,687</u>	<u>\$ 484,243</u>	<u>\$ 227,923</u>	<u>\$ 223,531</u>

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

	Less Than 12 Months		Greater Than 12 Months		Total	
	Market Value	Unrealized Losses	Market Value	Unrealized Losses	Market Value	Unrealized Losses
<i>(Dollars in Thousands)</i>						
September 30, 2018						
Available for Sale						
U.S. Government Treasury	\$ 92,259	\$ 1,005	\$ 175,854	\$ 3,217	\$ 268,113	\$ 4,222
U.S. Government Agency	63,475	351	29,223	270	92,698	621
States and Political Subdivisions	34,928	164	14,831	112	49,759	276
Mortgage-Backed Securities	10	-	2	-	12	-
Total	<u>190,672</u>	<u>1,520</u>	<u>219,910</u>	<u>3,599</u>	<u>410,582</u>	<u>5,119</u>
Held to Maturity						
U.S. Government Treasury	4,900	112	29,501	590	34,401	702
States and Political Subdivisions	6,026	38	495	7	6,521	45
Mortgage-Backed Securities	90,516	1,498	55,089	2,354	145,605	3,852
Total	<u>\$ 101,442</u>	<u>\$ 1,648</u>	<u>\$ 85,085</u>	<u>\$ 2,951</u>	<u>\$ 186,527</u>	<u>\$ 4,599</u>
December 31, 2017						
Available for Sale						
U.S. Government Treasury	\$ 155,443	\$ 963	\$ 79,900	\$ 1,201	\$ 235,343	\$ 2,164
U.S. Government Agency	45,737	150	25,757	257	71,494	407
States and Political Subdivisions	82,999	320	5,549	58	88,548	378
Mortgage-Backed Securities	2	-	-	-	2	-
Total	<u>284,181</u>	<u>1,433</u>	<u>111,206</u>	<u>1,516</u>	<u>395,387</u>	<u>2,949</u>
Held to Maturity						
U.S. Government Treasury	77,861	298	14,939	143	92,800	441
States and Political Subdivisions	6,955	41	-	-	6,955	41
Mortgage-Backed Securities	56,030	469	30,216	743	86,246	1,212
Total	<u>\$ 140,846</u>	<u>\$ 808</u>	<u>\$ 45,155</u>	<u>\$ 886</u>	<u>\$ 186,001</u>	<u>\$ 1,694</u>

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

At September 30, 2018, there were 541 positions (combined AFS and HTM) with unrealized losses totaling \$9.7 million, of which 63 of these positions were U.S. government treasury securities guaranteed by the U.S. government and 309 of these positions were U.S. government agency and mortgage-backed securities issued by U.S. government sponsored entities, with the remaining 169 positions being municipal securities. Because the declines in the market value of these securities 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, 2018.

NOTE 3 – LOANS, NET

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

<i>(Dollars in Thousands)</i>	September 30, 2018	December 31, 2017
Commercial, Financial and Agricultural	\$ 239,044	\$ 218,166
Real Estate – Construction	87,672	77,966
Real Estate – Commercial Mortgage	596,391	535,707
Real Estate – Residential ⁽¹⁾	342,063	311,906
Real Estate – Home Equity	212,942	229,513
Consumer ⁽²⁾	295,642	280,234
Loans, Net of Unearned Income	<u>\$ 1,773,754</u>	<u>\$ 1,653,492</u>

⁽¹⁾ Includes loans in process with outstanding balances of \$10.1 million and \$9.1 million at September 30, 2018 and December 31, 2017, respectively.

⁽²⁾ Includes overdraft balances of \$1.6 million and \$1.6 million at September 30, 2018 and December 31, 2017, respectively.

Net deferred costs included in loans were \$1.6 million at September 30, 2018 and \$1.5 million at December 31, 2017.

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 and has pledged a blanket floating lien on all consumer loans, commercial loans, and construction loans to support available borrowing capacity at the Federal Reserve Bank of Atlanta.

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

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

<i>(Dollars in Thousands)</i>	September 30, 2018		December 31, 2017	
	Nonaccrual	90 + Days	Nonaccrual	90 + Days
Commercial, Financial and Agricultural	\$ 338	\$ -	\$ 629	\$ -
Real Estate – Construction	1,098	-	297	-
Real Estate – Commercial Mortgage	2,316	126	2,370	-
Real Estate – Residential	2,140	-	1,938	-
Real Estate – Home Equity	902	-	1,748	-
Consumer	73	-	177	36
Total Nonaccrual Loans	<u>\$ 6,867</u>	<u>\$ 126</u>	<u>\$ 7,159</u>	<u>\$ 36</u>

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 accruing past due loans by class of loans.

<i>(Dollars in Thousands)</i>	30-59 DPD	60-89 DPD	90 + DPD	Total Past Due	Total Current	Total Loans⁽¹⁾
September 30, 2018						
Commercial, Financial and Agricultural	\$ 71	\$ 65	\$ -	\$ 136	\$ 238,570	\$ 239,044
Real Estate – Construction	-	-	-	-	86,574	87,672
Real Estate – Commercial Mortgage	280	176	126	582	593,493	596,391
Real Estate – Residential	613	727	-	1,340	338,583	342,063
Real Estate – Home Equity	354	76	-	430	211,610	212,942
Consumer	1,059	263	-	1,322	294,247	295,642
Total Past Due Loans	\$ 2,377	\$ 1,307	\$ 126	\$ 3,810	\$ 1,763,077	\$ 1,773,754
December 31, 2017						
Commercial, Financial and Agricultural	\$ 87	\$ 55	\$ -	\$ 142	\$ 217,395	\$ 218,166
Real Estate – Construction	811	-	-	811	76,858	77,966
Real Estate – Commercial Mortgage	437	195	-	632	532,705	535,707
Real Estate – Residential	701	446	-	1,147	308,821	311,906
Real Estate – Home Equity	80	2	-	82	227,683	229,513
Consumer	1,316	413	36	1,765	278,292	280,234
Total Past Due Loans	\$ 3,432	\$ 1,111	\$ 36	\$ 4,579	\$ 1,641,754	\$ 1,653,492

⁽¹⁾ Total Loans include nonaccrual loans

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

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

<i>(Dollars in Thousands)</i>	Commercial, Financial, Agricultural	Real Estate Construction	Real Estate Commercial Mortgage	Real Estate Residential	Real Estate Home Equity	Consumer	Total
Three Months Ended							
September 30, 2018							
Beginning Balance	\$ 1,214	\$ 283	\$ 4,432	\$ 3,146	\$ 2,294	\$ 2,194	\$ 13,563
Provision for Loan Losses	388	86	(30)	50	120	290	904
Charge-Offs	(268)	-	(25)	(106)	(112)	(463)	(974)
Recoveries	78	-	222	107	47	272	726
Net Charge-Offs	(190)	-	197	1	(65)	(191)	(248)
Ending Balance	<u>\$ 1,412</u>	<u>\$ 369</u>	<u>\$ 4,599</u>	<u>\$ 3,197</u>	<u>\$ 2,349</u>	<u>\$ 2,293</u>	<u>\$ 14,219</u>
Nine Months Ended							
September 30, 2018							
Beginning Balance	\$ 1,191	\$ 122	\$ 4,346	\$ 3,206	\$ 2,506	\$ 1,936	\$ 13,307
Provision for Loan Losses	481	253	208	123	140	1,259	2,464
Charge-Offs	(591)	(7)	(315)	(669)	(427)	(1,667)	(3,676)
Recoveries	331	1	360	537	130	765	2,124
Net Charge-Offs	(260)	(6)	45	(132)	(297)	(902)	(1,552)
Ending Balance	<u>\$ 1,412</u>	<u>\$ 369</u>	<u>\$ 4,599</u>	<u>\$ 3,197</u>	<u>\$ 2,349</u>	<u>\$ 2,293</u>	<u>\$ 14,219</u>
Three Months Ended							
September 30, 2017							
Beginning Balance	\$ 1,095	\$ 114	\$ 3,825	\$ 3,384	\$ 2,524	\$ 2,300	\$ 13,242
Provision for Loan Losses	208	(26)	286	(32)	(103)	157	490
Charge-Offs	(276)	-	(94)	(125)	(50)	(455)	(1,000)
Recoveries	79	50	69	60	84	265	607
Net Charge-Offs	(197)	50	(25)	(65)	34	(190)	(393)
Ending Balance	<u>\$ 1,106</u>	<u>\$ 138</u>	<u>\$ 4,086</u>	<u>\$ 3,287</u>	<u>\$ 2,455</u>	<u>\$ 2,267</u>	<u>\$ 13,339</u>
Nine Months Ended							
September 30, 2017							
Beginning Balance	\$ 1,198	\$ 168	\$ 4,315	\$ 3,445	\$ 2,297	\$ 2,008	\$ 13,431
Provision for Loan Losses	401	(80)	264	(348)	148	1,004	1,389
Charge-Offs	(693)	-	(643)	(285)	(142)	(1,616)	(3,379)
Recoveries	200	50	150	475	152	871	1,898
Net Charge-Offs	(493)	50	(493)	190	10	(745)	(1,481)
Ending Balance	<u>\$ 1,106</u>	<u>\$ 138</u>	<u>\$ 4,086</u>	<u>\$ 3,287</u>	<u>\$ 2,455</u>	<u>\$ 2,267</u>	<u>\$ 13,339</u>

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.

<i>(Dollars in Thousands)</i>	Commercial, Financial, Agricultural	Real Estate Construction	Real Estate Commercial Mortgage	Real Estate Residential	Real Estate Home Equity	Consumer	Total
September 30, 2018							
Period-end amount							
Allocated to:							
Loans Individually							
Evaluated for Impairment	\$ 185	\$ 181	\$ 1,719	\$ 954	\$ 357	\$ 1	\$ 3,397
Loans Collectively							
Evaluated for Impairment	1,227	188	2,880	2,243	1,992	2,292	10,822
Ending Balance	<u>\$ 1,412</u>	<u>\$ 369</u>	<u>\$ 4,599</u>	<u>\$ 3,197</u>	<u>\$ 2,349</u>	<u>\$ 2,293</u>	<u>\$ 14,219</u>
December 31, 2017							
Period-end amount							
Allocated to:							
Loans Individually							
Evaluated for Impairment	\$ 215	\$ 1	\$ 2,165	\$ 1,220	\$ 515	\$ 1	\$ 4,117
Loans Collectively							
Evaluated for Impairment	976	121	2,181	1,986	1,991	1,935	9,190
Ending Balance	<u>\$ 1,191</u>	<u>\$ 122</u>	<u>\$ 4,346</u>	<u>\$ 3,206</u>	<u>\$ 2,506</u>	<u>\$ 1,936</u>	<u>\$ 13,307</u>
September 30, 2017							
Period-end amount							
Allocated to:							
Loans Individually							
Evaluated for Impairment	\$ 88	\$ 24	\$ 1,846	\$ 1,196	\$ 454	\$ 3	\$ 3,611
Loans Collectively							
Evaluated for Impairment	1,018	114	2,240	2,091	2,001	2,264	9,728
Ending Balance	<u>\$ 1,106</u>	<u>\$ 138</u>	<u>\$ 4,086</u>	<u>\$ 3,287</u>	<u>\$ 2,455</u>	<u>\$ 2,267</u>	<u>\$ 13,339</u>

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

<i>(Dollars in Thousands)</i>	Commercial, Financial, Agricultural	Real Estate Construction	Real Estate Commercial Mortgage	Real Estate Residential	Real Estate Home Equity	Consumer	Total
September 30, 2018							
Individually Evaluated for Impairment	\$ 987	\$ 1,159	\$ 18,572	\$ 11,369	\$ 2,241	\$ 90	\$ 34,418
Collectively Evaluated for Impairment	238,057	86,513	577,819	330,694	210,701	295,552	1,739,336
Total	\$ 239,044	\$ 87,672	\$ 596,391	\$ 342,063	\$ 212,942	\$ 295,642	\$ 1,773,754
December 31, 2017							
Individually Evaluated for Impairment	\$ 1,378	\$ 361	\$ 19,280	\$ 12,871	\$ 3,332	\$ 113	\$ 37,335
Collectively Evaluated for Impairment	216,788	77,605	516,427	299,035	226,181	280,121	1,616,157
Total	\$ 218,166	\$ 77,966	\$ 535,707	\$ 311,906	\$ 229,513	\$ 280,234	\$ 1,653,492
September 30, 2017							
Individually Evaluated for Impairment	\$ 847	\$ 363	\$ 20,716	\$ 13,258	\$ 2,915	\$ 132	\$ 38,231
Collectively Evaluated for Impairment	215,116	67,450	506,615	302,325	225,584	275,017	1,592,107
Total	\$ 215,963	\$ 67,813	\$ 527,331	\$ 315,583	\$ 228,499	\$ 275,149	\$ 1,630,338

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, 2018				
Commercial, Financial and Agricultural	\$ 987	\$ 105	\$ 882	\$ 185
Real Estate – Construction	1,159	61	1,098	181
Real Estate – Commercial Mortgage	18,572	2,071	16,501	1,719
Real Estate – Residential	11,369	1,914	9,455	954
Real Estate – Home Equity	2,241	719	1,522	357
Consumer	90	51	39	1
Total	\$ 34,418	\$ 4,921	\$ 29,497	\$ 3,397
December 31, 2017				
Commercial, Financial and Agricultural	\$ 1,378	\$ 118	\$ 1,260	\$ 215
Real Estate – Construction	361	297	64	1
Real Estate – Commercial Mortgage	19,280	1,763	17,517	2,165
Real Estate – Residential	12,871	1,516	11,355	1,220
Real Estate – Home Equity	3,332	1,157	2,175	515
Consumer	113	45	68	1
Total	\$ 37,335	\$ 4,896	\$ 32,439	\$ 4,117

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2018		2017		2018		2017	
	Average Recorded Investment	Total Interest Income	Average Recorded Investment	Total Interest Income	Average Recorded Investment	Total Interest Income	Average Recorded Investment	Total Interest Income
<i>(Dollars in Thousands)</i>								
Commercial, Financial and Agricultural	\$ 1,040	\$ 19	\$ 963	\$ 12	\$ 1,185	\$ 69	\$ 1,051	\$ 35
Real Estate – Construction	915	2	363	-	716	3	334	2
Real Estate – Commercial Mortgage	18,470	167	21,109	219	18,666	511	22,283	662
Real Estate – Residential	11,393	133	14,068	162	12,215	417	14,608	516
Real Estate – Home Equity	2,415	23	3,114	28	2,840	74	3,280	81
Consumer	92	2	136	2	102	6	148	6
Total	\$ 34,325	\$ 346	\$ 39,753	\$ 423	\$ 35,724	\$ 1,080	\$ 41,704	\$ 1,302

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

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

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

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

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

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

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

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

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

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

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

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

<i>(Dollars in Thousands)</i>	Commercial, Financial, Agriculture	Real Estate	Consumer	Total Criticized Loans
September 30, 2018				
Special Mention	\$ 357	\$ 12,674	\$ 56	\$ 13,087
Substandard	594	26,058	386	27,038
Doubtful	-	-	-	-
Total Criticized Loans	<u>\$ 951</u>	<u>\$ 38,732</u>	<u>\$ 442</u>	<u>\$ 40,125</u>
December 31, 2017				
Special Mention	\$ 7,879	\$ 13,324	\$ 65	\$ 21,268
Substandard	1,057	29,291	654	31,002
Doubtful	-	-	-	-
Total Criticized Loans	<u>\$ 8,936</u>	<u>\$ 42,615</u>	<u>\$ 719</u>	<u>\$ 52,270</u>

Troubled Debt Restructurings ("TDRs"). TDRs are loans in which the borrower is experiencing financial difficulty and the Company has granted an economic concession to the borrower that it would not otherwise consider. In these instances, as part of a work-out alternative, the Company will make concessions including the extension of the loan term, a principal moratorium, a reduction in the interest rate, or a combination thereof. The impact of the TDR modifications and defaults are factored into the allowance for loan losses on a loan-by-loan basis as all TDRs are, by definition, impaired loans. Thus, specific reserves are established based upon the results of either a discounted cash flow analysis or the underlying collateral value, if the loan is deemed to be collateral dependent. A TDR classification can be removed if the borrower's financial condition improves such that the borrower is no longer in financial difficulty, the loan has not had any forgiveness of principal or interest, and the loan is subsequently refinanced or restructured at market terms and qualifies as a new loan.

The following table presents loans classified as TDRs.

<i>(Dollars in Thousands)</i>	September 30, 2018		December 31, 2017	
	Accruing	Nonaccruing	Accruing	Nonaccruing
Commercial, Financial and Agricultural	\$ 650	\$ 219	\$ 822	\$ -
Real Estate – Construction	61	-	64	-
Real Estate – Commercial Mortgage	15,847	1,226	17,058	1,636
Real Estate – Residential	9,980	1,120	11,666	503
Real Estate – Home Equity	2,033	97	2,441	186
Consumer	90	-	113	-
Total TDRs	\$ 28,661	\$ 2,662	\$ 32,164	\$ 2,325

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

<i>(Dollars in Thousands)</i>	Three Months Ended September 30, 2018			Nine Months Ended September 30, 2018		
	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	\$ 498	\$ 230
Real Estate – Construction	-	-	-	-	-	-
Real Estate – Commercial Mortgage	-	-	-	1	227	228
Real Estate – Residential	1	72	76	2	105	108
Real Estate – Home Equity	-	-	-	1	27	27
Consumer	-	-	-	-	-	-
Total TDRs	1	\$ 72	\$ 76	5	\$ 857	\$ 593

<i>(Dollars in Thousands)</i>	Three Months Ended September 30, 2017			Nine Months Ended September 30, 2017		
	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	\$ 32	\$ 22	1	\$ 32	\$ 22
Real Estate – Construction	-	-	-	1	64	65
Real Estate – Commercial Mortgage	1	160	70	1	160	70
Real Estate – Residential	1	101	102	2	316	283
Real Estate – Home Equity	3	149	147	4	205	203
Consumer	-	-	-	-	-	-
Total TDRs	6	\$ 442	\$ 341	9	\$ 777	\$ 643

For the three and nine months ended September 30, 2018, the loans modified as TDRs within the previous 12 months that have substantially defaulted are presented below. For the three and nine month period ended September 30, 2017, there were no loans modified as TDRs within the previous 12 months that have substantially defaulted.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018		2018	
	Number of Contracts	Post-Modified Recorded Investment⁽¹⁾	Number of Contracts	Post-Modified Recorded Investment⁽¹⁾
<i>(Dollars in Thousands)</i>				
Commercial, Financial and Agricultural	-	\$ -	-	\$ -
Real Estate – Construction	-	-	-	-
Real Estate – Commercial Mortgage	-	-	1	64
Real Estate – Residential	-	-	-	-
Real Estate – Home Equity	-	-	-	-
Consumer	-	-	-	-
Total TDRs	-	\$ -	1	\$ 64

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018		2018	
	Number of Contracts	Recorded Investment⁽¹⁾	Number of Contracts	Recorded Investment⁽¹⁾
<i>(Dollars in Thousands)</i>				
Extended amortization	1	\$ 76	2	\$ 303
Interest rate adjustment	-	-	1	33
Extended amortization and interest rate adjustment	-	-	1	27
Principal moratorium	-	-	1	230
Total TDRs	1	\$ 76	5	\$ 593

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017		2017	
	Number of Contracts	Recorded Investment⁽¹⁾	Number of Contracts	Recorded Investment⁽¹⁾
<i>(Dollars in Thousands)</i>				
Extended amortization	1	\$ 70	1	\$ 70
Interest rate adjustment	-	-	3	302
Extended amortization and interest rate adjustment	4	249	4	249
Other	1	22	1	22
Total TDRs	6	\$ 341	9	\$ 643

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

NOTE 4 – OTHER REAL ESTATE OWNED

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

<i>(Dollars in Thousands)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Beginning Balance	\$ 3,373	\$ 7,968	\$ 3,941	\$ 10,638
Additions	420	339	1,260	2,024
Valuation Write-downs	(224)	(350)	(856)	(1,118)
Sales	(849)	(1,970)	(1,625)	(5,291)
Other	-	-	-	(266)
Ending Balance	<u>\$ 2,720</u>	<u>\$ 5,987</u>	<u>\$ 2,720</u>	<u>\$ 5,987</u>

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

<i>(Dollars in Thousands)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Gains from the Sale of Properties	\$ (46)	\$ (711)	\$ (127)	\$ (980)
Losses from the Sale of Properties	70	123	212	318
Rental Income from Properties	(3)	(19)	(9)	(73)
Property Carrying Costs	102	139	289	397
Valuation Adjustments	224	350	856	1,118
Total	<u>\$ 347</u>	<u>\$ (118)</u>	<u>\$ 1,221</u>	<u>\$ 780</u>

As of September 30, 2018, the Company had \$0.7 million of loans secured by residential real estate in the process of foreclosure.

NOTE 5 - EMPLOYEE BENEFIT PLANS

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

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

<i>(Dollars in Thousands)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Service Cost	\$ 1,721	\$ 1,688	\$ 5,163	\$ 5,064
Interest Cost	1,415	1,437	4,246	4,312
Expected Return on Plan Assets	(2,391)	(2,006)	(7,173)	(6,019)
Prior Service Cost Amortization	50	56	150	167
Net Loss Amortization	918	953	2,754	2,859
Net Periodic Benefit Cost	<u>\$ 1,713</u>	<u>\$ 2,128</u>	<u>\$ 5,140</u>	<u>\$ 6,383</u>
Discount Rate	3.71%	4.21%	3.71%	4.21%
Long-term Rate of Return on Assets	7.25%	7.25%	7.25%	7.25%

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

<i>(Dollars in Thousands)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Interest Cost	\$ 57	\$ 48	\$ 170	\$ 143
Net Loss Amortization	406	149	1,220	448
Net Periodic Benefit Cost	<u>\$ 463</u>	<u>\$ 197</u>	<u>\$ 1,390</u>	<u>\$ 591</u>
Discount Rate	3.53%	3.92%	3.53%	3.92%

The service cost component of net periodic benefit cost is reflected in compensation expense in the accompanying statements of income. The other components of net periodic cost are included in "other" within the noninterest expense category in the statements of income. See Note 1 – Significant Accounting Policies for additional information.

During the first nine months of 2018, the Company contributed \$23 million (first quarter - \$10 million, second quarter - \$10 million, third quarter - \$3 million) to its defined benefit pension plan for the 2017 plan year.

NOTE 6 - COMMITMENTS AND CONTINGENCIES

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

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

<i>(Dollars in Thousands)</i>	September 30, 2018			December 31, 2017		
	Fixed	Variable	Total	Fixed	Variable	Total
Commitments to Extend Credit ⁽¹⁾	\$ 96,591	\$ 365,224	\$ 461,815	\$ 78,390	\$ 366,750	\$ 445,140
Standby Letters of Credit	4,363	-	4,363	4,678	-	4,678
Total	\$ 100,954	\$ 365,224	\$ 466,178	\$ 83,068	\$ 366,750	\$ 449,818

⁽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 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. Associated with this sale, the Company entered into a swap contract with the purchaser of the shares that requires a payment to the counterparty in the event that Visa, Inc. makes subsequent revisions to the conversion ratio for its Class B shares. Fixed charges included in the swap liability are payable quarterly until the litigation reserve is fully liquidated and at which time the aforementioned swap contract will be terminated. Quarterly fixed payments approximate \$123,000. Conversion ratio payments and ongoing fixed quarterly charges are reflected in earnings in the period incurred.

NOTE 7 – FAIR VALUE MEASUREMENTS

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

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis

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

In general, the Company does not purchase securities that have a complicated structure. The Company's entire portfolio consists of traditional investments, nearly all of which are U.S. Treasury obligations, federal agency bullet or mortgage pass-through securities, or general obligation or revenue based municipal bonds. Pricing for such instruments is easily obtained. Quarterly, the Company will validate, on a sample basis, prices supplied by the independent pricing service by comparison to prices obtained from third-party sources or derived using internal models.

Fair Value Swap. The Company entered into a stand-alone derivative contract with the purchaser of its Visa Class B shares. The valuation represents the amount due and payable to the counterparty based upon the revised share conversion rate, if any, during the period. At September 30, 2018, there were no amounts payable.

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

<i>(Dollars in Thousands)</i>	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
September 30, 2018				
ASSETS:				
Securities Available for Sale:				
U.S. Government Treasury	\$ 268,113	\$ -	\$ -	\$ 268,113
U.S. Government Agency	-	153,091	-	153,091
States and Political Subdivisions	-	53,839	-	53,839
Mortgage-Backed Securities	-	972	-	972
Equity Securities	-	8,228	-	8,228
December 31, 2017				
ASSETS:				
Securities Available for Sale:				
U.S. Government Treasury	\$ 235,341	\$ -	\$ -	\$ 235,341
U.S. Government Agency	-	144,644	-	144,644
States and Political Subdivisions	-	91,157	-	91,157
Mortgage-Backed Securities	-	1,185	-	1,185
Equity Securities	-	8,584	-	8,584

Assets Measured at Fair Value on a Non-Recurring Basis

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

Impaired Loans. Impairment for collateral dependent loans is measured using the fair value of the collateral less selling costs. The fair value of collateral is determined by an independent valuation or professional appraisal in conformance with banking regulations. Collateral values are estimated using Level 3 inputs due to the volatility in the real estate market, and the judgment and estimation involved in the real estate appraisal process. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly. Valuation techniques are consistent with those techniques applied in prior periods. Impaired collateral dependent loans had a carrying value of \$6.3 million with a valuation allowance of \$0.8 million at September 30, 2018 and \$6.1 million and \$1.1 million, respectively, at December 31, 2017.

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

Other Real Estate Owned. During the first nine months of 2018, certain foreclosed assets, upon initial recognition, were measured and reported at fair value through a charge-off to the allowance for loan losses based on the fair value of the foreclosed asset less estimated cost to sell. The fair value of the foreclosed asset is determined by an independent valuation or professional appraisal in conformance with banking regulations. On an ongoing basis, we obtain updated appraisals on foreclosed assets and realize valuation adjustments as necessary. The fair value of foreclosed assets is estimated using Level 3 inputs due to the judgment and estimation involved in the real estate valuation process.

Assets and Liabilities Disclosed at Fair Value

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

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

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

Loans. The loan portfolio is segregated into categories and the fair value of each loan category is calculated using present value techniques based upon projected cash flows and estimated discount rates. For values reported prior to 2018, the discount rates used to projecting cash flows reflected the credit and interest rate 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. Pursuant to the adoption of ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*, for values reported for the 2018 period, fair value reflects the incorporation of a liquidity discount to meet the objective of “exit price” valuation.

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

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

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

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

<i>(Dollars in Thousands)</i>	September 30, 2018			
	Carrying Value	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
ASSETS:				
Cash	\$ 48,423	\$ 48,423	\$ -	\$ -
Short-Term Investments	26,839	26,839	-	-
Investment Securities, Available for Sale	484,243	268,113	216,130	-
Investment Securities, Held to Maturity	227,923	34,401	189,130	-
Equity Securities ⁽¹⁾	3,600	-	3,600	-
Loans Held for Sale	8,297	-	8,297	-
Loans, Net of Allowance for Loan Losses	1,759,535	-	-	1,723,355
LIABILITIES:				
Deposits	\$ 2,381,216	\$ -	\$ 2,379,106	\$ -
Short-Term Borrowings	16,644	-	16,644	-
Subordinated Notes Payable	52,887	-	41,575	-
Long-Term Borrowings	12,456	-	12,330	-

<i>(Dollars in Thousands)</i>	December 31, 2017			
	Carrying Value	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
ASSETS:				
Cash	\$ 58,419	\$ 58,419	\$ -	\$ -
Short-Term Investments	227,023	227,023	-	-
Investment Securities, Available for Sale	480,911	235,341	245,570	-
Investment Securities, Held to Maturity	216,679	97,815	117,192	-
Loans Held for Sale	4,817	-	4,817	-
Loans, Net of Allowance for Loan Losses	1,640,185	-	-	1,625,310
LIABILITIES:				
Deposits	\$ 2,469,877	\$ -	\$ 2,382,818	\$ -
Short-Term Borrowings	7,480	-	7,482	-
Subordinated Notes Payable	52,887	-	41,718	-
Long-Term Borrowings	13,967	-	14,081	-

⁽¹⁾ *Not readily marketable securities - reflected in other assets.*

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

NOTE 8 – OTHER COMPREHENSIVE INCOME

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

<i>(Dollars in Thousands)</i>	Before Tax Amount	Tax (Expense) Benefit	Net of Tax Amount
Three Months Ended September 30, 2018			
Investment Securities:			
Change in net unrealized gain/loss on securities available for sale	\$ (553)	\$ 140	\$ (413)
Amortization of losses on securities transferred from available for sale to held to maturity	13	(3)	10
Total Other Comprehensive Loss	\$ (540)	\$ 137	\$ (403)

Nine Months Ended September 30, 2018			
Investment Securities:			
Change in net unrealized gain/loss on securities available for sale	\$ (2,306)	\$ 585	\$ (1,721)
Amortization of losses on securities transferred from available for sale to held to maturity	42	(11)	31
Total Other Comprehensive Loss	\$ (2,264)	\$ 574	\$ (1,690)

<i>(Dollars in Thousands)</i>	Before Tax Amount	Tax (Expense) Benefit	Net of Tax Amount
Three Months Ended September 30, 2017			
Investment Securities:			
Change in net unrealized gain/loss on securities available for sale	\$ (99)	\$ 38	\$ (61)
Amortization of losses on securities transferred from available for sale to held to maturity	19	(7)	12
Total Other Comprehensive Loss	\$ (80)	\$ 31	\$ (49)

Nine Months Ended September 30, 2017			
Investment Securities:			
Change in net unrealized gain/loss on securities available for sale	\$ 516	\$ (200)	\$ 316
Amortization of losses on securities transferred from available for sale to held to maturity	57	(22)	35
Total Other Comprehensive Income	\$ 573	\$ (222)	\$ 351

Accumulated other comprehensive loss was comprised of the following components:

<i>(Dollars in Thousands)</i>	Securities Available for Sale	Retirement Plans	Accumulated Other Comprehensive Loss
Balance as of January 1, 2018	\$ (1,743)	\$ (30,301)	\$ (32,044)
Other comprehensive loss during the period	(1,690)	-	(1,690)
Balance as of September 30, 2018	<u>\$ (3,433)</u>	<u>\$ (30,301)</u>	<u>\$ (33,734)</u>
Balance as of January 1, 2017	\$ (583)	\$ (25,642)	\$ (26,225)
Other comprehensive income during the period	351	-	351
Balance as of September 30, 2017	<u>\$ (232)</u>	<u>\$ (25,642)</u>	<u>\$ (25,874)</u>

NOTE 9 – ACCOUNTING STANDARDS UPDATES

ASU 2014-09, “Revenue from Contracts with Customers (Topic 606).” ASU 2014-09 implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. The Company adopted ASU 2014-09 January 1, 2018. See Note 1 – Significant Accounting Policies for additional information.

ASU 2016-02, “Leases (Topic 842).” ASU 2016-02 requires the lease rights and obligations arising from lease contracts, including existing and new arrangements, to be recognized as assets and liabilities on the balance sheet. ASU 2016-02 is effective for the Company on January 1, 2019 and is not expected to have a significant impact on its financial statements.

ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Statements.” ASU 2016-13 requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization’s portfolio. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 will be effective for the Company on January 1, 2020. The Company is currently evaluating the potential impact of ASU 2016-13 on its financial statements and related disclosures. As part of its implementation efforts to date, management has formed a cross-functional implementation team and developed a project plan. The Company has also engaged a vendor to assist in model development. The data set-up process is near completion and the overall project plan remains on schedule. The Company expects the new guidance will result in an increase in the allowance for credit losses given the change from accounting for losses inherent in the loan portfolio to accounting for losses over the remaining expected life of the portfolio. However, since the magnitude of the anticipated increase in the allowance for credit losses will be impacted by economic conditions and trends in the Company’s portfolio at the time of adoption, the quantitative impact cannot yet be reasonably estimated.

ASU 2018-03, “Technical Corrections and Improvements to Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.” ASU 2018-03 clarifies certain aspects of the guidance issued in ASU 2016-01. This includes the ability to irrevocably elect to change the measurement approach for equity securities measured using the practical expedient (at cost plus or minus observable transactions less impairment) to a fair value method in accordance with Topic 820, Fair Value Measurement; clarification that if an observable transaction occurs for such securities, the adjustment is as of the observable transaction date; clarification that the prospective transition approach for equity securities without a readily determinable fair values is meant only for instances in which the practical expedient is elected; and various other clarifications. ASU 2018-03 was effective for the Company on July 1, 2018 and did not have a significant impact on its financial statements.

ASU 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement. ASU 2018-13 removes the requirement to disclose the amount of and reasons for transfers between Level 1 and Level 2 fair value measurements, the policy for timing of transfers between levels and the valuation processes for Level 3 fair value measurements. It also adds a requirement to disclose the changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value held at the end of the reporting period. For certain unobservable inputs, an entity may disclose other quantitative information (such as the median or arithmetic average) in lieu of the weighted average if the entity determines that other quantitative information would be a more reasonable and rational method to reflect the distribution of unobservable inputs used to develop Level 3 fair value measurements. ASU 2018-13 is effective for the Company January 1, 2020. The Company is currently evaluating the potential impact of ASU 2018-13 on its financial statements and related disclosures.

ASU 2018-14, "Compensation – Retirement Benefits – Defined Benefit Plans – General (Subtopic 715-20): Disclosure Framework – Changes to the Disclosure Requirements for Defined Benefit Plans. ASU 2018-14 removes the disclosure requirements to include amounts in accumulated other comprehensive income expected to be recognized as components of net periodic benefit cost over the next fiscal year and the amount and timing of plan assets expected to be returned to the employer. It also adds the requirement to disclose the weighted-average interest crediting rates for cash balance plans and other plans with promised interest crediting rates and an explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period. ASU 2018-14 is effective for the company January 1, 2021. The Company is currently evaluating the potential impact of ASU 2018-15 on its financial statements and related disclosures.

ASU 2018-15, "Intangibles – Goodwill and Other – Internal – Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract. ASU 2018-15 aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). ASU 2018-15 is effective for the company January 1, 2020. The Company is currently evaluating the potential impact of ASU 2018-15 on its financial statements and related disclosures.

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 2018 compares with prior years. Throughout this section, Capital City Bank Group, Inc., and subsidiaries, collectively, is referred to as "CCBG," "Company," "we," "us," or "our."

CAUTION CONCERNING FORWARD-LOOKING STATEMENTS

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

All forward-looking statements, by their nature, are subject to risks and uncertainties. Our actual future results may differ materially from those set forth in our forward-looking statements. Please see the Introductory Note and *Item 1A. Risk Factors* of our 2017 Report on Form 10-K, as updated in our subsequent quarterly reports filed on Form 10-Q, and in our other filings made from time to time with the SEC after the date of this report.

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

BUSINESS OVERVIEW

We are a financial holding company headquartered in Tallahassee, Florida, and we are the parent of our wholly owned subsidiary, Capital City Bank (the "Bank" or "CCB"). The Bank offers a broad array of products and services through a total of 59 full-service offices located in Florida, Georgia, and Alabama. The Bank offers commercial and retail banking services, as well as trust and asset management, and retail securities brokerage.

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

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 2017 Form 10-K.

NON-GAAP FINANCIAL MEASURE

We present a tangible common equity ratio and a tangible book value per diluted share that, in each case, removes the effect of goodwill resulting from merger and acquisition activity. We believe these measures are useful to investors because it allows investors to more easily compare our capital adequacy to other companies in the industry. The GAAP to non-GAAP reconciliation is provided below.

<i>(Dollars in Thousands)</i>	2018			2017			2016		
	Third	Second	First	Fourth	Third	Second	First	Fourth	
Shareowners' Equity (GAAP)	\$ 298,016	\$ 293,571	\$ 288,360	\$ 284,210	\$ 285,201	\$ 281,513	\$ 278,059	\$ 275,168	
Less: Goodwill (GAAP)	84,811	84,811	84,811	84,811	84,811	84,811	84,811	84,811	
Tangible Shareowners' Equity (non-GAAP)	A <u>213,205</u>	<u>208,760</u>	<u>203,549</u>	<u>199,399</u>	<u>200,390</u>	<u>196,702</u>	<u>193,248</u>	<u>190,357</u>	
Total Assets (GAAP)	2,819,190	2,880,278	2,924,832	2,898,794	2,790,842	2,814,843	2,895,531	2,845,197	
Less: Goodwill (GAAP)	84,811	84,811	84,811	84,811	84,811	84,811	84,811	84,811	
Tangible Assets (non-GAAP)	B \$ <u>2,734,379</u>	\$ <u>2,795,467</u>	\$ <u>2,840,021</u>	\$ <u>2,813,983</u>	\$ <u>2,706,031</u>	\$ <u>2,730,032</u>	\$ <u>2,810,720</u>	\$ <u>2,760,386</u>	
Tangible Common Equity Ratio (non-GAAP)	A/B 7.80%	7.47%	7.17%	7.09%	7.41%	7.21%	6.88%	6.90%	
Actual Diluted Shares Outstanding (GAAP)	C 17,127,846	17,114,380	17,088,419	17,071,107	17,045,326	17,025,148	16,978,681	16,949,359	
Diluted Tangible Book Value (non-GAAP)	A/C 12.45	12.20	11.91	11.68	11.76	11.55	11.38	11.23	

SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)
*(Dollars in Thousands, Except
(Per Share Data))*

	2018				2017				2016
	Third	Second	First	Fourth	Third	Second	First	Fourth	
Summary of Operations:									
Interest Income	\$ 25,392	\$ 24,419	\$ 23,214	\$ 22,627	\$ 22,341	\$ 21,422	\$ 20,540	\$ 20,832	
Interest Expense	1,769	1,649	1,451	1,138	1,080	926	804	773	
Net Interest Income	23,623	22,770	21,763	21,489	21,261	20,496	19,736	20,059	
Provision for Loan Losses	904	815	745	826	490	589	310	464	
Net Interest Income After									
Provision for Loan Losses	22,719	21,955	21,018	20,663	20,771	19,907	19,426	19,595	
Noninterest Income	13,308	12,542	12,477	12,897	12,996	13,135	12,718	12,778	
Noninterest Expense	28,699	28,393	27,906	26,897	26,707	27,921	27,922	27,560	
Income Before Income Taxes	7,328	6,104	5,589	6,663	7,060	5,121	4,222	4,813	
Income Tax Expense (Benefit) ⁽²⁾	1,338	101	(184)	6,660	2,505	1,560	1,478	1,517	
Net Income	5,990	6,003	5,773	3	4,555	3,561	2,744	3,296	
Net Interest Income (FTE)	\$ 23,785	\$ 22,917	\$ 21,943	\$ 21,808	\$ 21,595	\$ 20,799	\$ 20,006	\$ 20,335	
Per Common Share:									
Net Income Basic	\$ 0.35	\$ 0.35	\$ 0.34	\$ 0.00	\$ 0.27	\$ 0.21	\$ 0.16	\$ 0.20	
Net Income Diluted	0.35	0.35	0.34	0.00	0.27	0.21	0.16	0.20	
Cash Dividends Declared	0.09	0.07	0.07	0.07	0.07	0.05	0.05	0.05	
Diluted Book Value	17.40	17.15	16.87	16.65	16.73	16.54	16.38	16.23	
Diluted Tangible Book Value ⁽¹⁾	12.45	12.20	11.91	11.68	11.76	11.55	11.38	11.23	
Market Price:									
High	25.91	25.99	26.50	26.01	24.58	22.39	21.79	23.15	
Low	23.19	22.28	22.80	22.21	19.60	17.68	19.22	14.29	
Close	23.34	23.63	24.75	22.94	24.01	20.42	21.39	20.48	
Selected Average Balances:									
Loans, Net	\$ 1,747,093	\$ 1,691,287	\$ 1,647,612	\$ 1,640,738	\$ 1,638,578	\$ 1,608,629	\$ 1,585,561	\$ 1,573,264	
Earning Assets	2,535,292	2,566,006	2,592,465	2,511,985	2,466,287	2,502,030	2,529,207	2,423,388	
Total Assets	2,826,924	2,861,104	2,892,120	2,822,451	2,779,960	2,817,479	2,845,140	2,743,463	
Deposits	2,392,272	2,431,956	2,456,106	2,378,411	2,329,162	2,373,423	2,407,278	2,306,917	
Shareowners' Equity	297,757	291,806	287,502	288,044	285,296	281,661	278,489	278,943	
Common Equivalent Average Shares:									
Basic	17,056	17,045	17,028	16,967	16,965	16,955	16,919	16,809	
Diluted	17,125	17,104	17,073	17,050	17,044	17,016	16,944	16,913	
Performance Ratios:									
Return on Average Assets	0.84 %	0.84 %	0.81 %	0.00 %	0.65 %	0.51 %	0.39 %	0.48 %	
Return on Average Equity	7.98	8.25	8.14	0.00	6.33	5.07	4.00	4.70	
Net Interest Margin (FTE)	3.72	3.58	3.43	3.45	3.48	3.33	3.21	3.34	
Noninterest Income as % of									
Operating Revenue	36.04	35.52	36.44	37.51	37.94	39.05	39.19	38.91	
Efficiency Ratio	77.37	80.07	81.07	77.50	77.21	82.28	85.33	83.23	
Asset Quality:									
Allowance for Loan Losses	\$ 14,219	\$ 13,563	\$ 13,258	\$ 13,307	\$ 13,339	\$ 13,242	\$ 13,335	\$ 13,431	
Allowance for Loan Losses to Loans	0.80 %	0.78 %	0.80 %	0.80 %	0.82 %	0.81 %	0.84 %	0.86 %	
Nonperforming Assets ("NPAs")	9,587	9,114	10,644	11,100	12,545	15,934	17,799	19,171	
NPAs to Total Assets	0.34	0.32	0.36	0.38	0.45	0.57	0.61	0.67	
NPAs to Loans plus OREO	0.54	0.52	0.64	0.67	0.76	0.97	1.11	1.21	
Allowance to Non-Performing Loans	207.06	236.25	181.26	185.87	203.39	166.23	160.70	157.40	
Net Charge-Offs to Average Loans	0.06	0.12	0.20	0.21	0.10	0.17	0.10	0.20	
Capital Ratios:									
Tier 1 Capital	16.17 %	16.25 %	16.31 %	16.33 %	16.19 %	15.58 %	15.68 %	15.51 %	
Total Capital	16.94	17.00	17.05	17.10	16.96	16.32	16.44	16.28	
Common Equity Tier 1	13.43	13.46	13.44	13.42	13.26	12.72	12.77	12.61	
Leverage	10.99	10.69	10.36	10.47	10.48	10.20	9.95	10.23	
Tangible Common Equity ⁽¹⁾	7.80	7.47	7.17	7.09	7.41	7.21	6.88	6.90	

⁽¹⁾ Non-GAAP financial measure. See non-GAAP reconciliation on page 31.

⁽²⁾ Includes \$0.4 million, \$1.4 million and \$1.5 million income tax benefit in the third, second and first quarter of 2018, respectively, related to 2017 plan year pension plan contributions. Also, a \$4.1 million income tax expense adjustment in the fourth quarter, 2017 related to the Tax Cuts and Jobs act of 2017.

FINANCIAL OVERVIEW

A summary overview of our financial performance is provided below.

Results of Operations

- Net income of \$6.0 million, or \$0.35 per diluted share, for the third quarter of 2018 compared to net income of \$6.0 million, or \$0.35 per diluted share, for the second quarter of 2018, and net income of \$4.6 million, or \$0.27 per diluted share for the third quarter of 2017. For the first nine months of 2018, we realized net income of \$17.8 million, or \$1.04 per diluted share, compared to net income of \$10.9 million, or \$0.64 per diluted share, for the same period of 2017.
- Tax equivalent net interest income for the third quarter of 2018 was \$23.8 million compared to \$22.9 million for the second quarter of 2018 and \$21.6 million for the third quarter of 2017. For the first nine months of 2018, tax equivalent net interest income totaled \$68.6 million compared to \$62.4 million for the comparable period of 2017. The increase compared to all prior periods reflected higher interest rates and a favorable shift in the earning asset mix. Higher rates earned on overnight funds, investment securities, and variable rate loans were partially offset by a higher cost on our negotiated rate deposits.
- Provision for loan losses was \$0.9 million for the third quarter of 2018 compared to \$0.8 million for the second quarter of 2018 and \$0.5 million for the third quarter of 2017. For the first nine months of 2018, the loan loss provision was \$2.5 million compared to \$1.4 million for the same period of 2017. The higher provision in 2018 reflected growth in the loan portfolio.
- Noninterest income for the third quarter of 2018 totaled \$13.3 million, an increase of \$0.8 million, or 6.1%, over the second quarter of 2018 and \$0.3 million, or 2.4%, over the third quarter of 2017. The increase over the second quarter of 2018 was primarily due to higher deposit fees and wealth management fees. A higher level of deposit fees, bank card fees, and other income drove the increase over the third quarter of 2017. For the first nine months of 2018, noninterest income totaled \$38.3 million, a \$0.5 million, or 1.3%, decrease from the same period of 2017, primarily due to lower mortgage banking fees and deposit fees, partially offset by higher wealth management fees and bank card fees.
- Noninterest expense for the third quarter of 2018 totaled \$28.7 million, an increase of \$0.3 million, or 1.1%, over the second quarter of 2018 and \$2.0 million, or 7.5% over the third quarter of 2017. For the first nine months of 2018, noninterest expense totaled \$85.0 million, an increase of \$2.5 million, or 3.0%, over the same period of 2017. Compared to the second quarter of 2018, the increase was primarily attributable to a non-routine operating loss. The increase over the three and nine month periods of 2017 was mostly attributable to an increase in other expense, primarily professional fees, and to a lesser extent higher compensation, other real estate owned (“OREO”) expense and a non-routine operating loss.

Financial Condition

- Average earning assets were \$2.535 billion for the third quarter of 2018, a decrease of \$30.7 million, or 1.2%, from the second quarter of 2018, and an increase of \$23.3 million, or 0.9%, over the fourth quarter of 2017. The change in average earning assets compared to the second quarter 2018 was attributable to a decrease in short-term investments, primarily due to a decline in seasonal public fund balances and certificates of deposit. The change in average earning assets over the fourth quarter 2017 was attributable to growth in the loan and investment portfolios primarily funded by increases in noninterest bearing deposits and savings accounts.
- Average loans increased by \$55.8 million, or 3.3%, over the second quarter of 2018, and \$106.4 million, or 6.5%, over the fourth quarter of 2017. The increase compared to both prior periods reflected growth in all loans types except home equity loans.
- Nonperforming assets totaled \$9.6 million at September 30, 2018, representing an increase of \$0.5 million, or 5.2%, over June 30, 2018 and a decrease of \$1.5 million, or 13.6%, from December 31, 2017. Nonperforming assets represented 0.34% of total assets at September 30, 2018 compared to 0.32% at June 30, 2018 and 0.38% at December 31, 2017.
- At September 30, 2018, we were well-capitalized with a risk based capital ratio of 16.94% and a tangible common equity ratio of 7.80% compared to 17.00% and 7.47%, respectively, at June 30, 2018, and 17.10% and 7.09%, respectively, at December 31, 2017. All of our regulatory capital ratios exceeded the threshold to be well-capitalized under the Basel III capital standards.

RESULTS OF OPERATIONS

Net Income

For the third quarter of 2018, we realized net income of \$6.0 million, or \$0.35 per diluted share, compared to net income of \$6.0 million, or \$0.35 per diluted share for the second quarter of 2018, and net income of \$4.6 million, or \$0.27 per diluted share for the third quarter of 2017. Net income for the third quarter of 2018 included a tax benefit of \$0.4 million, or \$0.02 per diluted share related to a 2017 plan year pension contribution made during the quarter as well as a non-routine operating loss of \$0.2 million, or \$0.01 per diluted share.

For the first nine months of 2018, net income totaled \$17.8 million, or \$1.04 per diluted share, compared to net income of \$10.9 million, or \$0.64 per diluted share for the same period of 2017. Net income for 2018 included tax benefits totaling \$3.3 million, or \$0.19 per diluted share related to 2017 plan year pension contributions made during 2018.

Compared to the second quarter of 2018, the \$1.2 million increase in operating profit reflected a \$0.8 million increase in net interest income and higher noninterest income of \$0.8 million, partially offset by higher noninterest expense of \$0.3 million and a \$0.1 million increase in the loan loss provision.

Compared to the third quarter of 2017, the \$0.3 million increase in operating profit was attributable to higher net interest income of \$2.4 million and higher noninterest income of \$0.3 million, partially offset by a \$2.0 million increase in noninterest expense, and a \$0.4 million increase in the loan loss provision.

The increase in operating profit of \$2.6 million for the first nine months of 2018 versus the comparable period of 2017 was attributable to higher net interest income of \$6.7 million, partially offset by lower noninterest income of \$0.5 million, higher noninterest expense of \$2.5 million, and \$1.1 million increase in the loan loss provision.

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

<i>(Dollars in Thousands, except per share data)</i>	Three Months Ended			Nine Months Ended	
	September 30, 2018	June 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Interest Income	\$ 25,392	\$ 24,419	\$ 22,341	\$ 73,025	\$ 64,303
Taxable Equivalent Adjustments	162	147	334	489	907
Total Interest Income (FTE)	25,554	24,566	22,675	73,514	65,210
Interest Expense	1,769	1,649	1,080	4,869	2,810
Net Interest Income (FTE)	23,785	22,917	21,595	68,645	62,400
Provision for Loan Losses	904	815	490	2,464	1,389
Taxable Equivalent Adjustments	162	147	334	489	907
Net Interest Income After Provision for Loan Losses	22,719	21,955	20,771	65,692	60,104
Noninterest Income	13,308	12,542	12,996	38,327	38,849
Noninterest Expense	28,699	28,393	26,707	84,998	82,550
Income Before Income Taxes	7,328	6,104	7,060	19,021	16,403
Income Tax Expense (Benefit)	1,338	101	2,505	1,255	5,543
Net Income	\$ 5,990	\$ 6,003	\$ 4,555	\$ 17,766	\$ 10,860
Basic Net Income Per Share	\$ 0.35	\$ 0.35	\$ 0.27	\$ 1.04	\$ 0.64
Diluted Net Income Per Share	\$ 0.35	\$ 0.35	\$ 0.27	\$ 1.04	\$ 0.64

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 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 47.

Tax-equivalent net interest income for the third quarter of 2018 was \$23.8 million compared to \$22.9 million for the second quarter of 2018 and \$21.6 million for the third quarter of 2017. The increase in tax-equivalent net interest income compared to both prior periods reflected higher interest rates and a favorable shift in the earning asset mix. Higher rates were earned on overnight funds, investment securities, and variable rate loans, partially offset by a higher cost on our negotiated rate deposits. For the first nine months of 2018, tax equivalent net interest income totaled \$68.6 million compared to \$62.4 million for the comparable period of 2017. The year-over-year increase was driven by growth in the loan and investment portfolios, coupled with higher short-term rates, partially offset by a higher rate paid on negotiated rate deposits.

The federal funds target rate has been increased eight times since December 2015 to 2.25% at the end of the third quarter of 2018, which positively affected our net interest income due to favorable repricing of our variable and adjustable rate earning assets. Although these increases have also resulted in higher rates paid on our negotiated rate deposit products, we continue to prudently manage our overall cost of funds, which was 28 basis points for the third quarter of 2018 compared to 26 basis points for the second quarter of 2018. In conjunction with our overall balance sheet management, we continue to review our deposit board rates to determine whether rate increases are appropriate. Various deposit products are available for our more rate sensitive clients. In the event deposit rate increases occur, we would expect to experience an increase in our cost of funds as these increases are gradually implemented.

Our net interest margin for the third quarter of 2018 was 3.72%, an increase of 14 basis points over the second quarter of 2018 and an increase of 25 basis points over the third quarter of 2017. For the first nine months of 2018, the net interest margin increased 24 basis points to 3.58% compared to the same period of 2017. The increase in the margin as compared to all prior periods reflected rising interest rates and a favorable shift in our earning asset mix, which has produced higher net interest income in each period.

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.

Provision for Loan Losses

The provision for loan losses for the third quarter of 2018 was \$0.9 million compared to \$0.8 million for the second quarter of 2018 and \$0.5 million for the third quarter of 2017. For the first nine months of 2018, the loan loss provision was \$2.5 million compared to \$1.4 million for the same period of 2017. The higher provision in 2018 reflected growth in the loan portfolio. We realized net loan charge-offs of \$0.2 million, or 0.06% (annualized), of average loans for the third quarter of 2018. This compares to net loan charge-offs of \$0.5 million, or 0.12% (annualized) for the second quarter of 2018 and net charge-offs of \$0.4 million, or 0.10% (annualized) for the third quarter of 2017. For the first nine months of 2018, net charge-offs totaled \$1.6 million, or 0.12% (annualized), of average loans compared to \$1.5 million, or 0.12% (annualized), for the same period of 2017.

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

	Three Months Ended			Nine Months Ended	
	September 30, 2018	June 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
<i>(Dollars in Thousands, except per share data)</i>					
CHARGE-OFFS					
Commercial, Financial and Agricultural	\$ 268	\$ 141	\$ 276	\$ 591	\$ 693
Real Estate - Construction	-	-	-	7	-
Real Estate - Commercial Mortgage	25	-	94	315	643
Real Estate - Residential	106	456	125	669	285
Real Estate - Home Equity	112	157	50	427	142
Consumer	463	509	455	1,667	1,616
Total Charge-offs	\$ 974	\$ 1,263	\$ 1,000	\$ 3,676	\$ 3,379
RECOVERIES					
Commercial, Financial and Agricultural	\$ 78	\$ 87	\$ 79	\$ 331	\$ 200
Real Estate - Construction	-	-	50	1	50
Real Estate - Commercial Mortgage	222	15	69	360	150
Real Estate - Residential	107	346	60	537	475
Real Estate - Home Equity	47	22	84	130	152
Consumer	272	283	265	765	871
Total Recoveries	\$ 726	\$ 753	\$ 607	\$ 2,124	\$ 1,898
Net Charge-offs	\$ 248	\$ 510	\$ 393	\$ 1,552	\$ 1,481
Net Charge-offs (Annualized) as a percent of Average Loans Outstanding, Net of Unearned Income	0.06 %	0.12 %	0.10 %	0.12 %	0.12 %

Noninterest Income

Noninterest income for the third quarter of 2018 totaled \$13.3 million, an increase of \$0.8 million, or 6.1%, over the second quarter of 2018 and \$0.3 million, or 2.4%, over the third quarter of 2017. Compared to the second quarter of 2018, the increase was primarily due to higher deposit fees, wealth management fees, mortgage banking fees and other income. A higher level of deposit fees, bank card fees, and other income drove the increase over the third quarter of 2017. For the first nine months of 2018, noninterest income totaled \$38.3 million, a \$0.5 million, or 1.3%, decrease from the same period of 2017, primarily due to lower mortgage banking fees of \$0.7 million and deposit fees of \$0.4 million, partially offset by higher wealth management fees of \$0.3 million and bank card fees of \$0.2 million.

Noninterest income represented 36.0% of operating revenues (net interest income plus noninterest income) in the third quarter of 2018 compared to 35.5% in the second quarter of 2018 and 37.9% in the third quarter of 2017. For the first nine months of 2018, noninterest income represented 36.0% of operating revenues compared to 38.7% for the same period of 2017.

The table below reflects the major components of noninterest income.

<i>(Dollars in Thousands)</i>	Three Months Ended			Nine Months Ended	
	September 30, 2018	June 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Deposit Fees	\$ 5,207	\$ 4,842	\$ 5,153	\$ 14,921	\$ 15,295
Bank Card Fees	2,828	2,909	2,688	8,548	8,361
Wealth Management Fees	2,181	2,037	2,197	6,391	6,112
Mortgage Banking Fees	1,343	1,206	1,480	3,606	4,344
Other	1,749	1,548	1,478	4,861	4,737
Total Noninterest Income	\$ 13,308	\$ 12,542	\$ 12,996	\$ 38,327	\$ 38,849

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

Deposit Fees. Deposit fees for the third quarter of 2018 totaled \$5.2 million, an increase of \$0.4 million, or 7.5%, over the second quarter of 2018, and comparable to the third quarter of 2017. For the first nine months of 2018, deposit fees totaled \$14.9 million, a decrease of \$0.4 million, or 2.4%, from the same period of 2017. The increase over the second quarter of 2018 reflected the migration of our deposit products from a free to fee checking account model. The decrease from the prior year period reflected lower overdraft service fees due to a reduction in accounts using this service as well as lower utilization by existing users.

Wealth Management Fees. Wealth management fees, which include both trust fees (i.e., managed accounts, trusts/estates, and retirement plans) and retail brokerage fees (i.e., investment and insurance products) totaled \$2.2 million for the third quarter of 2018, an increase of \$0.1 million, or 7.1%, over the second quarter of 2018 and comparable to the third quarter of 2017. For the first nine months of 2018, wealth management fees totaled \$6.4 million, an increase of \$0.3 million, or 4.6%, over the same period of 2017. At September 30, 2018, total assets under management were approximately \$1.496 billion compared to \$1.418 billion at December 31, 2017 and \$1.370 billion at September 30, 2017.

Mortgage Banking Fees. Mortgage banking fees totaled \$1.3 million for the third quarter of 2018, an increase of \$0.1 million, or 11.4%, over the second quarter of 2018 and a decrease of \$0.1 million, or 9.3%, from the third quarter of 2017. For the first nine months of 2018, fees totaled \$3.6 million, a decrease of \$0.7 million, or 17%, from the same period of 2017. The lower level of mortgage banking fees was due to a slowdown in secondary market loan production as adjustable rate loan production has picked up momentum and is being retained in our loan portfolio instead of sold on the secondary market. Total residential loan production (secondary market sales and portfolio) during the first nine months of 2018 was comparable to the prior year.

Noninterest Expense

Noninterest expense for the third quarter of 2018 totaled \$28.7 million, an increase of \$0.3 million, or 1.1%, over the second quarter of 2018 and \$2.0 million, or 7.5%, over the third quarter of 2017. For the first nine months of 2018, noninterest expense totaled \$85.0 million, a \$2.5 million, or 3.0%, increase over the same period of 2017. Compared to the second quarter of 2018, the increase was primarily attributable to a non-routine operating loss which is reflected in other expense. The increase over the three and nine month periods of 2017 was mostly attributable to an increase in other expense, primarily professional fees, but to a lesser extent, a non-routine operating loss, higher compensation expense and other real estate owned (“OREO”) expense. The increase in professional fees was related to consulting engagements that were essentially complete by the end of the third quarter.

The table below reflects the major components of noninterest expense.

<i>(Dollars in Thousands)</i>	Three Months Ended			Nine Months Ended	
	September 30, 2018	June 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Salaries	\$ 12,012	\$ 11,869	\$ 11,793	\$ 35,755	\$ 35,118
Associate Benefits	3,879	3,928	3,918	11,844	12,093
Total Compensation	15,891	15,797	15,711	47,599	47,211
Premises	2,234	2,191	2,205	6,634	6,626
Equipment	2,411	2,312	2,296	7,065	6,811
Total Occupancy	4,645	4,503	4,501	13,699	13,437
Legal Fees	500	569	405	1,545	1,428
Professional Fees	1,315	1,374	816	3,835	2,605
Processing Services	1,439	1,724	1,567	4,695	4,913
Advertising	433	412	296	1,133	1,293
Travel and Entertainment	262	277	194	719	590
Printing and Supplies	159	162	115	484	478
Telephone	547	581	502	1,722	1,858
Postage	160	182	185	548	586
Insurance - Other	418	408	409	1,228	1,221
Other Real Estate Owned, net	347	248	(118)	1,221	780
Miscellaneous	2,583	2,156	2,124	6,570	6,150
Total Other	8,163	8,093	6,495	23,700	21,902
Total Noninterest Expense	\$ 28,699	\$ 28,393	\$ 26,707	\$ 84,998	\$ 82,550

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

Compensation. Compensation expense totaled \$15.9 million for the third quarter of 2018, an increase of \$0.1 million, or 0.6%, over the second quarter of 2018 and an increase of \$0.2 million, or 1.2%, over the third quarter of 2017. For the first nine months of 2018, compensation expense totaled \$47.6 million, an increase of \$0.4 million, or 0.8%, over the same period of 2017 and reflected higher salary expense of \$0.6 million, partially offset by lower associate benefit expense of \$0.2 million. The increase in salary expense was attributable to higher cash incentive plan expense reflective of improved performance. The reduction in associate benefit expense was primarily due to lower stock compensation expense.

Other. Other noninterest expense totaled \$8.2 million for the third quarter of 2018, an increase of \$0.1 million, or 0.9%, over the second quarter of 2018 and \$1.7 million, or 25.7%, over the third quarter of 2017. The increase compared to second quarter of 2018 was primarily attributable to a non-routine operating loss of \$0.4 million, partially offset by lower processing services of \$0.3 million. Compared to the third quarter of 2017, the increase was primarily attributable to higher professional fees of \$0.5 million OREO expense of \$0.5 million, and the aforementioned non-routine operating loss. The higher level of professional fees reflected costs associated with several consulting projects, including both profit enhancements projects and the upgrading of ancillary systems, all of which were essentially complete by the end of the third quarter. The increase in OREO expense reflected a \$0.7 million decline in property sale gains which spiked in the third quarter of 2017. For the first nine months of 2018, other expense increased \$1.8 million, or 8.2%, over the same period of 2017, which was primarily attributable to higher professional fees of \$1.2 million, OREO expense of \$0.4 million, and miscellaneous expense of \$0.4 million. The increase in professional fees was related to the aforementioned consulting engagements. The higher level of OREO expense was primarily attributable to the aforementioned third quarter 2017 spike in property sales gains and the increase in miscellaneous expense was related to the aforementioned non-routine operating loss.

Our operating efficiency ratio (expressed as noninterest expense as a percent of the sum of taxable-equivalent net interest income plus noninterest income) was 77.4% for the third quarter of 2018 compared to 80.1% for the second quarter of 2018 and 77.2% for the third quarter of 2017. For the first nine months of 2018, this ratio was 79.5% compared to 81.5% for the same period of 2017.

Income Taxes

For the first nine months of 2018, we realized income tax expense of \$1.3 million, which reflected three discrete tax benefit items totaling \$3.3 million resulting from the effect of federal tax reform, enacted in December 2017, specifically related to pension plan contributions made in 2018 for the plan year 2017. The discrete tax items for 2018 totaled \$1.5 million for the first quarter, \$1.4 million for the second quarter and \$0.4 million for the third quarter. Absent these discrete items, our effective tax rate was approximately 24%.

FINANCIAL CONDITION

Average earning assets were \$2.535 billion for the third quarter of 2018, a decrease of \$30.7 million, or 1.2%, from the second quarter of 2018, and an increase of \$23.3 million, or 0.9%, over the fourth quarter of 2017. The change in average earning assets compared to the second quarter 2018 was attributable to decreases in our short-term investments, primarily due to a decline in our seasonal public fund balances. The change in average earning assets over the fourth quarter 2017 was attributable to growth in our loan and investment portfolios primarily funded by increases in our noninterest bearing deposits and savings accounts.

Investment Securities

In the third quarter of 2018, our average investment portfolio increased \$8.6 million, or 1.2%, over the second quarter of 2018 and increased \$27.9 million, or 4.0%, over the fourth quarter of 2017. Securities in our investment portfolio represented 28.6% of our average earning assets in the third quarter of 2018, compared to 27.9% in the second quarter of 2018, and 27.7% in the fourth quarter of 2017. For the remainder of 2018, we will continue to closely monitor liquidity levels to determine the extent to which investment cash flow may be reinvested into securities.

The investment portfolio is a significant component of our operations and, as such, it functions as a key element of liquidity and asset/liability management. Two types of classifications are approved for investment securities which are Available-for-Sale ("AFS") and Held-to-Maturity ("HTM"). During the third quarter of 2018, we purchased securities under both the AFS and HTM designations. At September 30, 2018, \$484.2 million, or 68.0%, of our investment portfolio was classified as AFS, and \$227.9 million, or 32.0%, classified as HTM. The average maturity of our total portfolio at September 30, 2018 was 2.16 years compared to 2.21 years and 1.96 years at June 30, 2018 and December 31, 2017, respectively.

We determine the classification of a security at the time of acquisition based on how the purchase will affect our asset/liability strategy and future business plans and opportunities. We consider multiple factors in determining classification, including regulatory capital requirements, volatility in earnings or other comprehensive income, and liquidity needs. Securities in the AFS portfolio are recorded at fair value with unrealized gains and losses associated with these securities recorded net of tax, in the accumulated other comprehensive income component of shareowners' equity. HTM securities are acquired or owned with the intent of holding them to maturity (final payment date). HTM investments are measured at amortized cost. We do not trade, nor do we presently intend to begin trading investment securities for the purpose of recognizing gains and therefore we do not maintain a trading portfolio.

At September 30, 2018, there were 541 positions (combined AFS and HTM) with unrealized losses totaling \$9.7 million. GNMA mortgage-backed securities, U.S. treasury securities ("UST"), and Small Business Administration ("SBA") investments carry the full faith and credit guarantee of the U.S. government, and are 0% risk-weighted assets for regulatory capital purposes. SBA securities float monthly or quarterly to the prime rate and are uncapped. Federal Home Loan Bank ("FHLB") and Federal Farm Credit Bureau ("FFCB") are direct obligations of U.S. government agencies. None of these positions with unrealized losses are considered impaired, and all are expected to mature at par. The table below provides further detail on investment securities with unrealized losses.

	Less Than 12 months			12 months or Longer			Total		
	Count	Market Value	Unrealized Losses	Count	Market Value	Unrealized Losses	Count	Market Value	Unrealized Losses
<i>(Dollars in Thousands)</i>									
GNMA	106	\$ 90,526	\$ 1,498	91	\$ 55,091	\$ 2,354	197	\$ 145,617	\$ 3,852
UST	20	97,159	1,117	43	205,355	3,807	63	302,514	4,924
SBA	91	63,475	351	6	3,554	31	97	67,029	382
FHLB and FFCB	0	-	-	15	25,669	239	15	25,669	239
States and Political Subdivisions	125	40,954	202	44	15,326	119	169	56,280	321
Total	342	\$ 292,114	\$ 3,168	199	\$ 304,995	\$ 6,550	541	\$ 597,109	\$ 9,718

Loans

Average loans increased \$55.8 million, or 3.3%, compared to the second quarter of 2018, and have grown \$106.4 million, or 6.5% compared to the fourth quarter of 2017. The increase compared to both prior periods reflected growth in all loans types except home equity loans. Over the course of 2018, we have purchased both adjustable rate residential loans and fixed and adjustable rate commercial real estate loan pools totaling \$25.1 million based on principal balances at the time of purchase.

We continue to make minor modifications on some of our lending programs to try to mitigate the impact that consumer and business deleveraging has had on our portfolio. These programs, coupled with economic improvements in our anchor markets, have helped to increase overall loan growth. In the current rising rate environment, we frequently review our fixed rate pricing relative to the market and implement rate increases as appropriate.

Nonperforming Assets

Nonperforming assets (nonaccrual loans and OREO) totaled \$9.6 million at September 30, 2018, representing an increase of \$0.5 million, or 5.2%, over June 30, 2018, and a decrease of \$1.5 million, or 13.6%, from December 31, 2017. Nonaccrual loans totaled \$6.9 million at September 30, 2018, a \$1.1 million increase over June 30, 2018 and a \$0.3 million decrease from December 31, 2017. The balance of OREO totaled \$2.7 million at September 30, 2018, a decrease of \$0.6 million from June 30, 2018 and a decrease of \$1.2 million from December 31, 2017. For the third quarter of 2018, we added properties totaling \$0.4 million, sold properties totaling \$0.9 million and recorded valuation adjustments totaling \$0.2 million.

<i>(Dollars in Thousands)</i>	September 30, 2018	June 30, 2018	December 30, 2017
Nonaccruing Loans:			
Commercial, Financial and Agricultural	\$ 338	\$ 455	\$ 629
Real Estate - Construction	1,098	609	298
Real Estate - Commercial Mortgage	2,316	2,181	2,370
Real Estate - Residential	2,140	1,543	1,938
Real Estate - Home Equity	902	910	1,748
Consumer	73	43	176
Total Nonperforming Loans ("NPLs") ⁽¹⁾	<u>\$ 6,867</u>	<u>\$ 5,741</u>	<u>\$ 7,159</u>
Other Real Estate Owned	2,720	3,373	3,941
Total Nonperforming Assets ("NPAs")	<u>\$ 9,587</u>	<u>\$ 9,114</u>	<u>\$ 11,100</u>
Past Due Loans 30 – 89 Days	\$ 3,684	\$ 3,472	\$ 4,543
Past Due Loans 90 Days or More (accruing)	126	-	36
Performing Troubled Debt Restructurings	\$ 28,661	\$ 29,981	\$ 32,164
Nonperforming Loans/Loans	0.39 %	0.33 %	0.43 %
Nonperforming Assets/Total Assets	0.34	0.32	0.38
Nonperforming Assets/Loans Plus OREO	0.54	0.52	0.67
Allowance/Nonperforming Loans	207.06 %	236.25 %	185.87 %

(1) Nonperforming TDRs are included in the NPL totals.

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

<i>(Dollars in Thousands)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
NPA Beginning Balance:	\$ 9,114	\$ 15,934	\$ 11,100	\$ 19,171
Change in Nonaccrual Loans:				
Beginning Balance	5,741	7,966	7,159	8,533
Additions	2,872	2,440	9,152	8,555
Charge-Offs	(364)	(644)	(2,077)	(2,246)
Transferred to OREO	(371)	(261)	(1,211)	(1,043)
Paid Off/Payments	(489)	(1,534)	(2,109)	(2,927)
Restored to Accrual	(522)	(1,409)	(4,047)	(4,314)
Ending Balance	6,867	6,558	6,867	6,558
Change in OREO:				
Beginning Balance	3,373	7,968	3,941	10,638
Additions	420	339	1,260	2,024
Valuation Write-downs	(224)	(350)	(856)	(1,118)
Sales	(849)	(1,970)	(1,625)	(5,291)
Other	-	-	-	(266)
Ending Balance	2,720	5,987	2,720	5,987
NPA Net Change	473	(3,389)	(1,513)	(6,626)
NPA Ending Balance	\$ 9,587	\$ 12,545	\$ 9,587	\$ 12,545

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

<i>(Dollars in Thousands)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
TDR Beginning Balance:	\$ 32,185	\$ 37,917	\$ 34,489	\$ 39,976
Additions	76	341	593	643
Charge-Offs	(136)	(5)	(527)	(458)
Paid Off/Payments	(767)	(2,416)	(2,828)	(4,284)
Removal Due to Change in TDR Status	-	-	(296)	-
Transferred to OREO	(35)	(85)	(108)	(125)
TDR Ending Balance⁽¹⁾	\$ 31,323	\$ 35,752	\$ 31,323	\$ 35,752

⁽¹⁾ Includes performing and nonaccrual TDR loan balances.

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 losses are probable and reasonably quantifiable. 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 \$14.2 million at September 30, 2018 compared to \$13.6 million at June 30, 2018, and \$13.3 million at December 31, 2017. The allowance for loan losses was 0.80% of outstanding loans (net of overdrafts) and provided coverage of 207% of nonperforming loans at September 30, 2018 compared to 0.78% and 236%, respectively, at June 30, 2018 and 0.80% and 186%, respectively, at December 31, 2017. We believe that the allowance for loan losses was adequate to absorb losses inherent in our loan portfolio at September 30, 2018.

Deposits

Average total deposits were \$2.392 billion for the third quarter of 2018, a decrease of \$39.7 million, or 1.6%, from the second quarter of 2018, and an increase of \$13.9 million, or 0.6%, over the fourth quarter of 2017. The decline in deposits compared to the second quarter of 2018 reflected lower public fund and certificates of deposit balances, partially offset by increases in noninterest bearing and savings accounts. The increase in deposits when compared to the fourth quarter of 2017 reflected growth in all deposit products except public fund, regular NOW accounts and certificates of deposit. Average public fund balances typically peak in the first quarter and trend downward through the middle of the fourth quarter due to the cycle of tax receipts.

Deposit levels continue to be closely monitored and managed in conjunction with runoff from the investment portfolio. We monitor deposit rates on an ongoing basis as a prudent pricing discipline remains the key to managing our mix of deposits.

MARKET RISK AND INTEREST RATE SENSITIVITY

Market Risk and Interest Rate Sensitivity

Overview. Market risk management arises from changes in interest rates, exchange rates, commodity prices, and equity prices. We have risk management policies to monitor and limit exposure to interest rate risk and do not participate in activities that give rise to significant market risk involving exchange rates, commodity prices, or equity prices. Our risk management policies are primarily 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 risk limits, 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 is designed to capture optionality factors such as call features and interest rate caps and floors imbedded in investment and loan portfolio contracts. As with any method of analyzing interest rate risk, there are certain shortcomings inherent in the interest rate modeling methodology that we use. 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 the assumptions that we use in our modeling. Finally, the methodology does not measure or reflect the impact that higher rates may have on variable and adjustable-rate loan clients' ability to service their debts, or the impact of rate changes on demand for loan and deposit products.

We prepare a current base case and several alternative simulations at least once per quarter and present the analysis to ALCO, with the risk metrics being reported 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 maintain expected changes in our net interest income and capital levels due to fluctuations in market interest rates within acceptable limits. Management attempts to achieve this goal by balancing, within policy limits, the volume of variable-rate liabilities with a similar volume of variable-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.

We test our balance sheet using varying interest rate shock scenarios to analyze our interest rate risk. Average interest rates are shocked by plus or minus 100, 200, 300, and 400 basis points ("bp"), although we may elect not to use particular scenarios that we determined are impractical in a current rate environment. It is management's goal to structure the balance sheet so that net interest earnings at risk over 12-month and 24-month periods, and the economic value of equity at risk do not exceed policy guidelines at the various interest rate shock levels.

A new “rates down 200 bp” shock scenario was modeled this quarter due to the current rate environment. This resulted in Net Interest Income at Risk over both 12 and 24-month periods, in addition to EVE, being outside of policy guidelines due to our limited ability to lower our deposit rates by 200 bp in response to a decline in market rates. At this time, management does not plan to take any immediate action to address the out-of-compliance situation in the rates down 200 bp scenario as all current indications suggest that rates will continue to rise. However, at some point in the future, when rates have reached a higher absolute level, we expect to readdress this decision.

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 and do not necessarily indicate the long-term prospects or economic value of the institution.

ESTIMATED CHANGES IN NET INTEREST INCOME ⁽¹⁾

Percentage Change (12-month shock)	+400 bp	+300 bp	+200 bp	+100 bp	-100 bp	-200 bp
Policy Limit	-15.0%	-12.5%	-10.0%	-7.5%	-7.5%	-10.0%
September 30, 2018	7.1%	5.3%	3.4%	1.9%	-5.1%	-11.9%
June 30,2018	9.2%	6.9%	4.5%	2.3%	-5.9%	n/a

Percentage Change (24-month shock)	+400 bp	+300 bp	+200 bp	+100 bp	-100 bp	-200 bp
Policy Limit	-17.5%	-15.0%	-12.5%	-10.0%	-10.0%	-12.5%
September 30, 2018	37.1%	29.3%	21.5%	14.1%	-5.7%	-18.6%
June 30,2018	37.7%	29.4%	21.1%	13.1%	-7.8%	n/a

The Net Interest Income at Risk position indicates that in the short-term, all rising rate environments will positively impact our net interest margin, while a declining rate environment of both 100bp and 200bp will have a negative impact on the net interest income. Compared to the prior quarter-end, the 12-month Net Interest Income at Risk positions declined in a rising rate environment, and became more favorable in the down 100bp scenario. The 24-month Net Interest Income at Risk positions also became more favorable in the down 100bp scenario, and were little changed in the rising rate environment compared to the prior quarter-end period. Rate shock down 200bp scenarios over 12 and 24-month periods were introduced this quarter.

All measures of Net Interest Income at Risk are within our prescribed policy limits over both the 12-month and 24-month periods, with the exception of rates down 200 bps. Quarter-over-quarter, in a rising rate environment, these metrics became less favorable as most of our high beta deposit rates are now off their floors, and can fully price in the higher rates. Metrics in the down 100 bp scenario became more favorable as we have a greater ability to lower our deposit rates relative to the decline in market rates. We are out of compliance in rates down 200 as we have a limited ability to lower our deposit rates the full 200 bps relative to the decline in market rate.

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 the aggregated 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 ⁽¹⁾

Changes in Interest Rates	+400 bp	+300 bp	+200 bp	+100 bp	-100 bp	-200 bp
Policy Limit	-30.0%	-25.0%	-20.0%	-15.0%	-15.0%	-20.0%
September 30, 2018	18.8%	15.0%	10.5%	6.3%	-12.4%	-33.3%
June 30,2018	24.0%	19.2%	13.6%	7.9%	-14.8%	n/a

At September 30, 2018, the economic value of equity results are favorable in all rising rate environments and are within prescribed tolerance levels with the exception of the rates down 200 bp scenario. The EVE in the rates down 200 bp scenario is new this quarter, and is outside desired parameters as we have limited ability to lower our deposit rates by 200 bps in response to a decline in market rate. At this time, management does not plan to take any immediate action to address the out-of-compliance situation in the down 200 bp scenario as all current indications suggest that rates will continue to rise. However, at some point in the future, when rates have reached a higher absolute level, management will readdress.

(1) Down 300 and 400 bp scenarios have been excluded due to the 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.

At September 30, 2018, we had the ability to generate \$1.416 billion in additional liquidity through all of our available resources (this excludes \$27 million in overnight funds sold). In addition to the 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. We conduct a liquidity stress test on a quarterly basis based on events that could potentially occur at the Bank and report results to ALCO, our Market Risk Oversight Committee, and the Board of Directors. At September 30, 2018, we believe the liquidity available to us was sufficient to meet our on-going needs and execute our business strategy.

We view our investment portfolio primarily as a source of liquidity and have the option to pledge the portfolio as collateral for borrowings or deposits, and/or sell selected securities. The portfolio consists of debt issued by the U.S. Treasury, U.S. governmental and federal agencies, and municipal governments. The weighted average life of the portfolio was approximately 2.16 years, and at September 30, 2018, the available for sale portfolio had a net unrealized pre-tax loss of \$4.4 million.

Our average overnight funds position (defined as funds sold plus interest bearing deposits with other banks less funds purchased) was \$63.6 million during the third quarter of 2018 compared to an average net overnight funds sold position of \$158.7 million in the second quarter of 2018 and \$174.6 million in the fourth quarter of 2017. The decrease in average net overnight funds compared to all prior periods reflected growth in our loan and investment portfolios. Additionally, part of the decrease compared to the second quarter of 2018 was attributable to the decline in our public deposits and certificates of deposit.

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

Borrowings

At September 30, 2018, fixed rate credit advances from the FHLB totaled \$10.3 million in outstanding debt consisting of 12 notes and one variable rate Daily Rate Credit (DRC) advance totaling \$10.0 million. During the first nine months of 2018, the Bank made FHLB advance payments totaling approximately \$1.5 million. One advance matured and no advances were paid off. We did not obtain any new fixed rate FHLB advances during this period, but did obtain one variable rate advance which we can pay off at any time without penalty. 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, of which \$10 million was retired in April 2016. 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 three-month LIBOR plus a margin of 1.90%. This note matures on December 31, 2034. The interest payment for the CCBG Capital Trust II borrowing is due quarterly and adjusts quarterly to a variable rate of three-month LIBOR plus a margin of 1.80%. This note matures on June 15, 2035. The proceeds from these borrowings were used to partially fund acquisitions. Under the terms of each junior subordinated deferrable interest note, in the event of default or if we elect to defer interest on the note, we may not, with certain exceptions, declare or pay dividends or make distributions on our capital stock or purchase or acquire any of our capital stock.

Capital

Shareowners' equity was \$298.0 million at September 30, 2018, compared to \$293.6 million at June 30, 2018 and \$284.2 million at December 31, 2017. Our leverage ratio was 10.99%, 10.69%, and 10.47%, respectively, on these dates. Further, at September 30, 2018, our risk-adjusted capital ratio was 16.94% compared to 17.00% and 17.10% at June 30, 2018 and December 31, 2017, respectively. Our common equity tier 1 ratio was 13.43% at September 30, 2018 compared to 13.46% and 13.42% at June 30, 2018 and December 31, 2017, respectively. All of our capital ratios exceeded the threshold to be designated as "well-capitalized" under the Basel III capital standards at September 30, 2018.

During the first nine months of 2018, shareowners' equity increased \$13.8 million, or 6.5%, on an annualized basis. During this same period, shareowners' equity was positively impacted by net income of \$17.8 million, stock compensation accretion of \$1.0 million, and net adjustments totaling \$0.6 million related to transactions under our stock compensation plans. Shareowners' equity was reduced by common stock dividends totaling \$3.9 million and a \$1.7 million net increase in the unrealized loss on investment securities.

At September 30, 2018, our common stock had a book value of \$17.40 per diluted share compared to \$17.15 at June 30, 2018 and \$16.65 at December 31, 2017. Book value is impacted through other comprehensive income by the net unrealized gains and losses in our available for sale investment portfolio. At September 30, 2018, the net after tax unrealized loss was \$3.4 million compared to \$3.0 million at June 30, 2018 and \$1.7 million at December 31, 2017. Book value is also impacted by the recording of our unfunded pension liability through other comprehensive income. At September 30, 2018, the net after tax pension liability reflected in accumulated other comprehensive loss was \$30.3 million. This liability is re-measured annually on December 31st based on an actuarial calculation of our pension liability. Significant assumptions used in calculating the liability are discussed in our 2017 Form 10-K "Critical Accounting Policies" and include the weighted average discount rate used to measure the present value of the pension liability, the weighted-average expected long-term rate of return on pension plan assets, and the assumed rate of annual compensation increases, all of which will vary when re-measured. The discount rate assumption used to calculate the pension liability is subject to long-term corporate bond rates at December 31st. The estimated impact to the pension liability based on a 25 basis point increase or decrease in long-term corporate bond rates used to discount the pension obligation would decrease or increase the pension liability by approximately \$5.3 million (after-tax) using the balances from the December 31, 2017 measurement date.

In February 2014, our Board of Directors authorized the repurchase of up to 1,500,000 shares of our outstanding common stock through February 2019. Repurchases may be made in the open market or in privately negotiated transactions; however, we are not obligated to repurchase any specified number of shares. We have not repurchased any shares during 2018. At September 30, 2018, we were authorized to repurchase up to 640,000 additional shares under the plan.

Impact of Hurricane Michael

On October 10, 2018, Hurricane Michael made landfall in Florida as a category 4 hurricane affecting areas of the panhandle region with significant wind/water damage and power outages. We have a limited number of banking offices, customers, and collateral properties located in the areas which were directly impacted by the storm. We are in the process of assessing the potential impact of the hurricane on the ability of our borrowers to repay their obligations, underlying collateral values and damage to our offices. While it is too soon to make any determination, based on our current information and assessment to date, we do not believe the effects of the hurricane will materially impact our operations.

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.

As of September 30, 2018, we had \$461.8 million in commitments to extend credit and \$4.4 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 our ability to meet our 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 2017 Form 10-K. The preparation of our Consolidated Financial Statements in accordance with GAAP and reporting practices applicable to the banking industry requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and to disclose contingent assets and liabilities. Actual results could differ from those estimates.

We have identified accounting for (i) the allowance for loan and lease losses, (ii) valuation of goodwill, (iii) pension benefits, and (iv) income taxes 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 2017 Form 10-K.

TABLE I
AVERAGE BALANCES & INTEREST RATES

(Dollars in Thousands)	Three Months Ended September 30,						Nine Months Ended September 30,					
	2018			2017			2018			2017		
	Average Balances	Interest	Average Rate	Average Balances	Interest	Average Rate	Average Balances	Interest	Average Rate	Average Balances	Interest	Average Rate
Assets:												
Loans ⁽¹⁾⁽²⁾	\$ 1,747,093	\$ 21,733	4.94%	\$ 1,638,578	\$ 19,672	4.76%	\$ 1,695,695	\$ 61,994	4.89%	\$ 1,611,117	\$ 56,689	4.70%
Taxable Securities ⁽²⁾	663,639	3,290	1.98	588,518	2,150	1.45	642,260	8,758	1.82	593,579	5,832	1.31
Tax-Exempt Securities	60,952	229	1.50	98,463	407	1.65	72,656	813	1.49	99,059	1,217	1.64
Funds Sold	63,608	302	1.88	140,728	446	1.26	153,767	1,949	1.69	195,189	1,472	1.01
Total Earning Assets	<u>2,535,292</u>	<u>25,554</u>	<u>4.00%</u>	<u>2,466,287</u>	<u>22,675</u>	<u>3.65%</u>	<u>2,564,378</u>	<u>73,514</u>	<u>3.83%</u>	<u>2,498,944</u>	<u>65,210</u>	<u>3.49%</u>
Cash & Due From Banks	49,493			51,880			50,844			51,043		
Allowance For Loan Losses	(14,146)			(13,542)			(13,774)			(13,547)		
Other Assets	256,285			275,335			258,363			277,514		
TOTAL ASSETS	<u>\$ 2,826,924</u>			<u>\$ 2,779,960</u>			<u>\$ 2,859,811</u>			<u>\$ 2,813,954</u>		
Liabilities:												
NOW Accounts	\$ 733,255	\$ 773	0.42%	\$ 755,620	\$ 339	0.18%	\$ 795,112	\$ 2,157	0.36%	\$ 813,858	\$ 694	0.11%
Money Market Accounts	254,440	190	0.30	262,486	80	0.12	252,082	459	0.24	261,118	172	0.09
Savings Accounts	352,833	43	0.05	327,675	40	0.05	349,527	128	0.05	320,634	118	0.05
Other Time Deposits	129,927	62	0.19	148,652	71	0.19	134,781	187	0.19	153,215	215	0.19
Total Interest Bearing Deposits	<u>1,470,455</u>	<u>1,068</u>	<u>0.30</u>	<u>1,494,433</u>	<u>530</u>	<u>0.14</u>	<u>1,531,502</u>	<u>2,931</u>	<u>0.27</u>	<u>1,548,825</u>	<u>1,199</u>	<u>0.11</u>
Short-Term Borrowings	12,949	41	1.24	9,920	15	0.59	9,499	57	0.80	10,552	77	0.97
Subordinated Notes Payable	52,887	568	4.20	52,887	420	3.11	52,887	1,595	3.98	52,887	1,203	3.00
Other Long-Term Borrowings	12,729	92	2.87	15,427	115	2.95	13,218	286	2.89	15,324	331	2.89
Total Interest Bearing Liabilities	<u>1,549,020</u>	<u>1,769</u>	<u>0.47%</u>	<u>1,572,667</u>	<u>1,080</u>	<u>0.28%</u>	<u>1,607,106</u>	<u>4,869</u>	<u>0.42%</u>	<u>1,627,588</u>	<u>2,810</u>	<u>0.24%</u>
Noninterest Bearing Deposits	921,817			834,729			895,042			820,843		
Other Liabilities	58,330			87,268			65,270			83,683		
TOTAL LIABILITIES	<u>2,529,167</u>			<u>2,494,664</u>			<u>2,567,418</u>			<u>2,532,114</u>		
TOTAL SHAREOWNERS' EQUITY	<u>297,757</u>			<u>285,296</u>			<u>292,393</u>			<u>281,840</u>		
TOTAL LIABILITIES AND SHAREOWNERS' EQUITY	<u>\$ 2,826,924</u>			<u>\$ 2,779,960</u>			<u>\$ 2,859,811</u>			<u>\$ 2,813,954</u>		
Interest Rate Spread			<u>3.53%</u>			<u>3.37%</u>			<u>3.41%</u>			<u>3.25%</u>
Net Interest Income	<u>\$ 23,785</u>			<u>\$ 21,595</u>			<u>\$ 68,645</u>			<u>\$ 62,400</u>		
Net Interest Margin ⁽³⁾			<u>3.72%</u>			<u>3.48%</u>			<u>3.58%</u>			<u>3.34%</u>

(1) Average Balances include nonaccrual loans.

(2) Interest income includes the effects of taxable equivalent adjustments using a 21% Federal tax rate for 2018 and a 35% Federal tax rate for 2017.

(3) Taxable equivalent net interest income divided by average earnings assets.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See “Market Risk and Interest Rate Sensitivity” in Management’s Discussion and Analysis of Financial Condition and Results of Operations, above, which is incorporated herein by reference. Management has determined that no additional disclosures are necessary to assess changes in information about market risk that have occurred since December 31, 2017.

Item 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

At September 30, 2018, 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 at September 30, 2018, 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 our 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 2017 Form 10-K, as updated in our subsequent quarterly reports. The risks described in our 2017 Form 10-K are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
None.

Item 3. Defaults Upon Senior Securities
None.

Item 4. Mine Safety Disclosure
Not Applicable.

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 2, 2018

50

[\(Back To Top\)](#)

Section 2: EX-31.1 (EXHIBIT 31.1)

Exhibit 31.1

**Certification of CEO Pursuant to Securities Exchange Act
Rule 13a-14(a) / 15d-14(a) as Adopted Pursuant to
Section 302 of the Sarbanes-Oxley Act of 2002**

I, William G. Smith, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Capital City Bank Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ William G. Smith, Jr.

William G. Smith, Jr.
Chairman, President and
Chief Executive Officer

Date: November 2, 2018

[\(Back To Top\)](#)

Section 3: EX-31.2 (EXHIBIT 31.2)

Exhibit 31.2

**Certification of CFO Pursuant to Securities Exchange Act
Rule 13a-14(a) / 15d-14(a) as Adopted Pursuant to
Section 302 of the Sarbanes-Oxley Act of 2002**

I, J. Kimbrough Davis, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Capital City Bank Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ J. Kimbrough Davis

J. Kimbrough Davis
Executive Vice President and
Chief Financial Officer

Date: November 2, 2018

[\(Back To Top\)](#)

Section 4: EX-32.1 (EXHIBIT 32.1)

Exhibit 32.1

Certification of CEO Pursuant to 18 U.S.C. Section 1350

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned certifies that (1) this Quarterly Report of Capital City Bank Group, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2018, as filed with the Securities and Exchange Commission on the date hereof (this "Report"), fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended, and (2) the information contained in this Report fairly presents, in all material respects, the financial condition of the Company and its results of operations as of and for the periods covered therein.

/s/ William G. Smith, Jr.

William G. Smith, Jr.
Chairman, President, and
Chief Executive Officer

Date: November 2, 2018

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

[\(Back To Top\)](#)

Section 5: EX-32.2 (EXHIBIT 32.2)

Exhibit 32.2

Certification of CFO Pursuant to 18 U.S.C. Section 1350

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned certifies that (1) this Quarterly Report of Capital City Bank Group, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2018, as filed with the Securities and Exchange Commission on the date hereof (this "Report"), fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended, and (2) the information contained in this Report fairly presents, in all material respects, the financial condition of the Company and its results of operations as of and for the periods covered therein.

/s/ J. Kimbrough Davis

J. Kimbrough Davis
Executive Vice President and
Chief Financial Officer

Date: November 2, 2018

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

[\(Back To Top\)](#)